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October 19, 2018

***Delivered via email***

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

The Canadian Bankers Association (**CBA**)[1] welcomes the opportunity to comment on 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* and the accompanying Companion Policy 31-103CP (the **Proposal**).

The CBA supports regulatory initiatives that are intended to enhance investor protection and improve outcomes for clients. The industry is continuously evolving to better meet clients' preferences (e.g., online robo-advisors). Dealers, investment fund managers and portfolio managers provide a variety of service offerings, ranging from self-directed investing to holistic financial planning, and serve a wide spectrum of investors, including individuals with modest amounts to invest, high net worth individuals and institutional investors. In order to serve the broadest segment of the population, the industry needs the flexibility to continue to accommodate different channels, tailor requirements to the particular business model, and be nimble with its service offerings in a quickly evolving industry. We are concerned that certain aspects of the Proposal are overly prescriptive and unduly burdensome. The Proposal could lead firms to reduce their product and service offerings, which could undermine the significant amount of product and

[1] The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

service choice currently available to investors. We encourage the CSA to be mindful of the importance of facilitating the ability of firms to offer an assortment of products and services and serve a range of clients when developing any reforms. We have set out below more detailed commentary on various aspects of the Proposal.

1. **Know Your Product (KYP)**

The Proposal imposes explicit KYP requirements for both registered firms and registered individuals. Registered firms would be required to take reasonable steps to understand the essential elements of the securities they offer and approve the securities they make available. In our view, the obligation to review and approve every single security offered for sale is unduly burdensome and unnecessary. The CSA should allow flexibility for registrants to implement efficient methods to conduct KYP (if applicable), such as bundling securities into groups and conducting KYP on the group. Further, registrants should be permitted to tailor KYP, if applicable, to the risk and complexity of the security.

The Proposal requires registered firms to understand how the securities they make available to clients compare with similar securities available in the market. We are concerned with a requirement for proprietary firms to engage in a market investigation and product comparison with respect to non-proprietary products. If a registered firm is only selling proprietary products, we question the policy rationale for an obligation to conduct a full KYP competitive analysis on securities in the market that the firm does not sell. Our member banks and their affiliates that only offer proprietary products already have in place comprehensive and effective KYP processes, including product approval committees that approve which proprietary products will be on the shelf, and are transparent about selling only proprietary products. The Proposal creates uncertainty as to the continued economic viability of proprietary firms and could incentivize some proprietary firms to move to a mixed product shelf. We believe that there is value in the availability of different business models to meet diverse investor needs and that the Proposal should not impede the operation of proprietary firms. Accordingly, proprietary firms should not be obligated to conduct a market evaluation of non-proprietary products.

Another instance where we believe the KYP requirement is not appropriate is for portfolio managers hired by investment fund managers in respect of investment funds. Currently, National Instrument 31-103 exempts portfolio managers from the know your client (**KYC**) and suitability requirements where the portfolio manager's client is a registered firm. We believe that this exemption should also apply in the KYP context, as the requirements are all connected. For example, suitability includes a KYP component; given that there is an exemption from suitability, it follows that an exemption from KYP would be reasonable.

We believe that the KYP obligation should not apply to portfolio managers of permitted clients in managed accounts. In CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients* (**Consultation Paper 33-404**), the CSA proposed targeted reforms to National Instrument 31-103 intended to better align the interests of registrants with the interests of their clients by enhancing registrant obligations. Notably, the Consultation Paper stated that the targeted reforms relating to suitability and KYC requirements would not apply to institutional clients. In our view, this carve-out should extend to the KYP obligation such that portfolio managers of permitted clients in managed accounts would not be required to conduct KYP. There are comprehensive investor protection mechanisms for such

clients, including through the investment management agreement, which includes a robust standard of care, and the investment policy statement.

The proposed enhanced KYP provisions will apply to a registered firm that accepts a transfer of assets into the adviser's account from another account. We are concerned that the application of the KYP provisions to a "transfer in" of securities already beneficially owned by a client will have the unintended effect of frustrating transfers of securities between firms to consolidate their holdings, or for other reasons, as the adviser for the transferee account may not have gone through the KYP institution-level approval process for the securities being transferred. The application of the new KYP requirements in the circumstances of a "transfer in" is exacerbated by the detailed, documented analysis that is prescribed as part of the process of firm-level KYP approval of a new product. We also note that under the Proposal, advisers will not be able to execute a client-directed trade of a security if an investor directs a purchase of a security that has not been KYP-approved by the firm. In both cases, the result is the imposition of unnecessary restrictions on the ability of investors to select advisers or to direct investments.

If a firm determines that it is impractical to conduct a full KYP assessment on a transferred security (for instance, the security is not on the firm's shelf and the firm has determined that it will not be adding the security to its shelf), it should be able to continue to hold the security in the client's account with the client's authorization. If the client were forced to sell the security, this would be contrary to the client's desires and could result in adverse tax consequences. Another option, which we believe is undesirable, is to decline to transfer the security. In addition to conflicting with the client's wishes, this would result in the client having a portfolio that is bifurcated between two advisers.

## 2. Conflicts of Interest

The Proposal states that registrants would have to address all existing and reasonably foreseeable conflicts of interest, including those that are not material, in the best interest of the client. The application of this requirement to *all* existing and reasonably foreseeable conflicts, with related disclosure of conflicts of interest, is likely to result in (i) an overwhelming amount of disclosure to investors that may not serve them well; and (ii) increased complexity of large, integrated firms to identify and manage conflicts, including immaterial conflicts. While registrants will always be acting for the benefit of their clients, we do not believe that this obligation should pertain to immaterial conflicts given the potential negative consequences to investors and firms noted above.

The Proposal provides examples of controls that registered firms that only trade in, or recommend, proprietary products could consider when determining how to address conflicts arising from proprietary products in the client's best interest. One such control is conducting periodic due diligence on comparable non-proprietary products available in the market and evaluating whether the proprietary products are competitive with the alternatives. As discussed above, we are concerned with the notion that proprietary firms should engage in a market investigation and product comparison with respect to non-proprietary products. While we appreciate that a comparative analysis may provide insights on other products available in the market place, it is unclear as to the purpose of such investigation if the dealer has determined to only offer proprietary products to clients and does so in a transparent manner. Such process would be an additional cost without a related commensurate benefit to investors.

Another example of a control that firms (both proprietary and mixed/non-proprietary) could use to address conflicts arising from proprietary products is obtaining independent advice on, or an independent evaluation of, the effectiveness of the firm's policies, procedures and controls to address this conflict. We seek clarification as to whether the expectation is for firms to retain an external consultant to provide the advice or conduct the evaluation. If an external consultant is expected, this could result in negative consequences to investors. First, a consultant would not have the deep product and service offering knowledge and, therefore, would be limited to metrics that may be short-term in nature and not aligned to the various client investment objectives. For example, the consultant may look at one and three year returns when the client hold period may be ten years. Second, if the external consultant recommended removal or substitution of an existing product based on certain metrics, existing investors in such products may be forced to redeem such holdings and potentially at a time that could result in negative tax consequences. An alternative control is to permit an internal evaluation of products, assisted by affiliated entities with deep market knowledge, which seeks to consider the product from the investor's expected hold period.

The companion policy disclosure for proprietary only firms indicates that such firms consider stating that non-proprietary products would be better, worse or equal in meeting the client's investment needs. In our view, existing disclosure to clients indicating that only proprietary offerings are available is sufficient to provide the transparency necessary for clients to make informed choices regarding their investment needs.

### 3. <u>Referral Arrangements</u>

The Proposal prohibits registrants from paying referral fees unless the party receiving the fee is also a registrant. We believe that this prohibition is overly broad and unnecessary given the other protections in the referral provisions regarding disclosure to clients, recordkeeping and the limitation on referral fees. This restriction hinders the ability to refer clients to the appropriate channels within a bank and therefore may not be in the client's best interest. We note in particular that referrals from affiliates of registered firms or from individuals who are subject to rules of professional conduct towards their clients, such as lawyers and accountants, should not be prohibited.

We assume that the CSA did not intend to capture internal payments between affiliates in the proposed restrictions on referral arrangements. Such payments represent reasonable compensation for the substantial infrastructure costs of operating a dealer firm, such as the costs of initial and ongoing education and registration of advisers, technology to support sales and regulatory processes, market research to meet evolving client needs and client support services, including phone, online and digital channels, without creating an undue sales incentive or conflict concerning the distribution of securities. In the case of affiliated entities, there is an opportunity cost associated with a representative considering the client's investment needs, referring such client to a registered firm within an integrated business model and following up on such referrals. Continuing to permit payment of referral fees to affiliated firms that refer to registrants seeks to ensure investors continue to be referred to the home of best fit for their investment needs.

### 4. <u>KYC and Suitability</u>

The CSA proposes to amend KYC requirements to require registrants to have a thorough understanding of their client, taking into consideration the nature of the specific client-registrant

relationship. The Proposal states that a registrant should tailor its KYC process to reflect its business model and the nature of its relationship with clients. Although this statement appears to give firms some flexibility to tailor their KYC processes, the proposed Companion Policy is overly prescriptive with respect to KYC obligations (for example, there is a list of terms and expressions that registrants should explain to clients). We request clarity regarding the degree of flexibility firms would have to fashion their KYC processes. In our view, the CSA should expressly provide for flexibility to reflect firms' various service and product offerings.

We observe that an adviser must rely on the information provided by the client to satisfy its KYC requirements, particularly in respect of information regarding the client's personal circumstances pursuant to the Proposal. Accordingly, we request clarification as to what steps, if any, should be taken by a registrant to verify the accuracy of the information provided by clients in response to KYC inquiries.

As discussed above, Consultation Paper 33-404 stated that the targeted reforms relating to suitability and KYC requirements would not apply to institutional clients. Consistent with Consultation Paper 33-404, we believe that the enhanced KYC and suitability obligations in the Proposal should not apply to portfolio managers of permitted clients in managed accounts, as such clients do not require these protections. Further, anti-money laundering requirements and annual client updates provide a sufficient level of KYC.

## 5. Training

The Proposal indicates that firms must provide compliance training, including product training, to ensure their registered representatives have a sufficient understanding of the securities and their risks. Further, as part of its KYP process to understand a security, a firm must understand how that security generally compares with similar securities available in the market. We are unclear as to the level of product training expected of registered representatives in firms that only offer proprietary products. Specifically, we request clarification as to whether, in such circumstances, there is an obligation to provide training on comparable non-proprietary products. If such training on comparable non-proprietary products is required, it would result in costs without a commensurate benefit, as representatives are not permitted to advise on third-party products.

## 6. Transition Period

Implementation of the Proposal will impact numerous systems, internal policies and procedures ranging from client onboarding to client engagement practices. A project of this magnitude will require careful planning, including an enterprise-wide reprioritization of projects and initiatives that are already underway.

Given the scope, significance and complexity of the Proposal, we believe that a lengthier transition period, with an opportunity for further consultation with securities regulators and self-regulatory organizations (**SROs**), is necessary. The implementation period should only begin to run after all related SRO rules are published in final form, including any related guidance and frequently asked questions documents.

We request that the CSA provide clarification of whether, or to what extent, the proposed enhanced KYC requirements are intended to apply to the existing investment accounts of existing clients. If it is intended that these proposals will apply to such existing accounts, we believe that the

contemplated transition period does not provide sufficient time for advisers to contact their clients to obtain the required additional KYC information or update existing KYC information. In a proprietary only channel, a registered firm may have more than two million existing accounts that will need to be updated. For all existing clients, we propose that the CSA should provide a three-year transition period to update KYC information.

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Thank you for considering our views on the Proposal. Please do not hesitate to contact me with any questions you may have.

Sincerely,