CUMBERLAND

Private Wealth

October 19, 2018

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:

The Secretary
Ontario Securities Commission
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comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Dear Sirs and Mesdames:

Re: Client Focused Reforms - 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 (Client Focused Reforms)

Cumberland Private Wealth Management Ltd. ('CPWM') appreciates the opportunity to provide comments to the Canadian Securities Association (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").

Overview:

The Client Focused Reforms, in general, represent the culmination of an extensive work effort by all participating to create a more level playing field in the wealth management business, where firms, participants and agencies are similarly regulated, and clients are serviced in a consistent manner, with a focus on their best interests, regardless of the channel by which they participate in drawing on services from the industry. The client's best interest is now infused into the Client Focused Reforms and there is no longer a focus on the statutory best interest standard for registrants. As a manager of individual client accounts and investment fund portfolios on a discretionary basis, CPWM has accepted and is currently held accountable to a fiduciary standard with respect to its clients. In fact, any portfolio manager, individual who holds a CFA charter or firm who manages pooled funds or accounts on a discretionary basis, is working under a fiduciary standard. We are unclear why the CSA would not permit an election by the firm or individual to continue to be governed by a fiduciary standard rather than be directed to a set of policies and rules that are attempting to impose a fiduciary-like standard through a set of overly prescribed policy rules and guidelines.

We are concerned that the highly prescriptive approach toward Know Your Product ('KYP'), and the enhanced Know Your Client ('KYC') and related suitability requirements is likely to frustrate many clients, many of whom are already working with individuals through a fiduciary standard relationship. It is our feeling that clients will be overwhelmed by the amount of additional prescribed information and time required by portfolio managers to obtain, maintain and update their financial advice program as set out in the proposals. The KYP proposals will result in increased compliance cost for firms and their clients, potentially leading to a rationalization of the number of investment solutions available to the detriment of investors. Most importantly, it appears that in the case where a fiduciary standard is already in existence, these changes will require a significant reworking of policies and processes to comply with the prescriptive nature of the Companion Policy intentions for little or no benefit to clients. While the Client Focused Reforms could provide some level of certainty for registrants and their compliance professionals, and level the playing field across distribution channels, it seems that the ability to allow for a choice between one model (fiduciary standard) or the other (Client Focused Reforms) might be preferable to and beneficial for clients and industry participants.

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, the clients and the various categories of industry participants. Only then can a reasoned analysis of whether the proposed benefits of the Client Focused Reforms be justified in light of the costs. 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. We are also surprised that there has been no withdrawal of other regulations and/or rule changes to potentially offset costs, complexity and workload associated with the proposed compliance regime.

General Issues/Concerns:

There are a number of common issues that run throughout the various sections of the Client Focused Reforms that we will highlight below. The industry is made up of individuals and organizations that are registered through different bodies, it is unclear that this process will capture the full client experience. It is common today that a client in pursuing a wealth solution is required to utilize tools such as insurance, debt management, financial planning, tax and estate practitioners and an investment advisor. We still are not seeing a direct linkage to the best interest standard infiltrating all these service providers; instead we are seeing a fracturing of these potential relationships with respect to the proposed referral arrangement reforms. The common issues include the following:

- Throughout the Client Focused Reforms, the concept of the “cost” appears to be paramount in determining how advisors determine suitability and manage conflicts of interest. While cost is one factor with respect to account performance, other factors such as, risk, time-frame, consistency of returns, diversity of holdings, management stability, overall market returns and the benefits of a managed program for investors must also be recognized as elements to be considered in respect of managing to the long-term needs of a client portfolio.
- We note that the terms “best interest” and “putting the client’s interest first” are not clearly defined or differentiated and therefore leaving us to conclude, given our business model that the intention is to create a standard that is consistent with or equivalent to a fiduciary standard, but with a prescriptive process and policy guideline which may inhibit a proper assessment of all the relevant facts, not just those highlighted in the proposals.
- Although the Companion Policy is intended only to provide guidance, it appears to transform guidelines, actions and process into actual new regulatory requirements.

KEY ELEMENTS OF THE CLIENT FOCUSED REFORMS

1. Know Your Client

We acknowledge the importance of a comprehensive KYC process as a critical element in ensuring clients receive a comprehensive wealth solution. While we support some of the provisions contained in the KYC Client Focused Reforms, we do have concerns with the prescriptive nature of the guidance and in our view, the overly extensive KYC requirements.

As an example, for advisors who only manage a portion of their client's overall wealth, it will be very challenging, if not impossible, to obtain a full breakdown of such client's financial assets and net worth. In many cases, particularly where advisors have a restricted mandate, such a request for information may not be relevant and will needlessly frustrate clients. As such, we are of the view that advisors should be permitted to exercise their own judgement to determine the scope of KYC information required and whether such information is in fact required from a client.

2. Know Your Product

We agree that understanding the features of a security for suitability purposes is fundamental to the advisory process. However, it is our belief that the ultimate goal in servicing a client as a discretionary investment manager is to create an investment portfolio that is comprised of many securities and investment solutions. We are concerned that certain elements of the proposed KYP requirements will present significant challenges for industry participants and clients in reconciling the focus placed on each specific security as opposed to the overall benefit and design of the investment portfolio that is already subject to a rigorous construction process.

The language in several sections in the Companion Policy appears to significantly limit firms' discretion and judgement in how it evaluates securities for use in client portfolios. In our view, the onerous proposed KYP requirements, which do not appear to contemplate any risk-based analysis, use of third-party product research, or bundling of like securities, may likely result in a reduction in the number and variety of securities and products that firms who exercise discretionary authority are able to incorporate into their client portfolios. This could negatively impact clients' access to diversified advice models, product innovation and the capital raising ability of Canadian public firms.

In addition, the obligations of individual advisors to have a high-level of understanding of all of the products on a firm's shelf seems to create duplicative assessment efforts. Many strategies, products and solutions have been or will be assessed by committees or individuals at the various firms, and many include risk assessments already as prescribed by regulation. As a result, incorporating into the proposals some ability for process streamlining and reliance on the work efforts or recommendations completed at the firm level would be beneficial, cost effective and helpful to the process of servicing clients.

3. Suitability

We agree with the CSA that the suitability obligation is fundamental in establishing a relationship between firms and their clients for the purpose of providing advice in the best interest of clients and designing a suitable investment portfolio. However, this is the basis that already exists with the fiduciary standard and incorporated already into the management of client accounts on a discretionary basis. We do have some concerns with the lack of clarity surrounding the requirement to put the client's interests first, and are trying to understand, in cases where a fiduciary relationship exists, what benefit is being contemplated by the proposals.

The Companion Policy does not 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 seem to 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 the Companion Policy.

With respect to the factors for determining suitability, the general catch-all provision of "any other factor that is relevant under the circumstances" seems too general a statement to operationalize.

We believe that "litmus test" for suitability is what a reasonable person would have done under the same or similar circumstances at the time of the suitability determination. We are unclear as to whether or not the suitability process may be enhanced with technology and/or the use of algorithms, or with the design and use of model portfolios under the proposed guidelines.

4. Conflicts of interest

We acknowledge that appropriate requirements are necessary to govern elements of the client-registrant relationships that raise conflict of interest concerns.

Materiality

We feel that the CSA's decision to remove the materiality standard in respect of the requirement for firms to identify and manage existing and potential conflicts of interest is an issue. This decision is inconsistent with existing IIROC and MFDA regulation in Canada, as well as the proposed 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. Again, we feel that the use of judgement is critical in the assessment of conflicts and that conflicts are inevitable in the comingling of money of consolidated management purposes.

Conflicts disclosure

We prefer the focus to be linked 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

Proprietary products, such as private pooled funds, can be cost effective vehicles used by firms to offer their clients access to different investment strategies and securities that might not otherwise be available. For example, an individual opening a Tax-Free Savings account will not have a sufficient account size to allow for a segregated security portfolio, but could utilize a pool fund, which pools assets from other investors, to gain exposure to a suitable investment portfolio chosen for a client. Imposing prescriptive conflict of interest requirements in respect of such proprietary products versus the use of a segregated security portfolio will increase the regulatory burden without providing corresponding investor protections, and may also, ultimately reduce the options available to clients. Portfolio managers who have proprietary pooled funds are the creators of such solutions and mandates, so it's not clear how the extensive KYP process as proposed would be necessary or appropriate in this type of situation.

Given the extensive KYP and KYC processes that firms must now undertake, we recommend that additional controls, such as monitoring the level of proprietary products in client accounts and obtaining independent advice of firms' efforts to address such conflict, 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 firm and/or the advisor's suitability analysis indicates that they are the better choice, vis-a-vis lower cost alternatives.

5. <u>Referral Arrangements</u>

We are concerned with the scope of the definition incorporated in the Client Focused Reforms for referral arrangements. In reality, a referral arrangement takes on many forms and likely needs to be segmented to define the specific situation that may exist under the umbrella term. For example, a referral arrangement may, in fact, be for a one-time introduction of a client to a portfolio manager. It may also cover an ongoing relationship which is established where one firm or individual provides ongoing services (tax, estate, or planning services) to the client in addition to the investment management services being provided by the portfolio manager. It is our opinion that clients are well served in situations where shared service relationships are established between individuals and firms with different skill sets. Increasing competition by allowing clients a broader set of choices, rather than purely sourcing an integrated relationship for services through large vertically integrated firm, is good for Canadians.

The new requirement in subsection 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 benefits, and may create unintended consequences, seemingly moving industry regulation away from the practical application today that clients are sourced through many channels and rely on a number of individuals to provide a holistic wealth management solution for their specific needs.

Firms and registrants are required to manage their client relationships in the context of their regulatory requirements, regardless of the way in which they have become a client, whether that be through referral for a fee, referral with no fee or through direct prospecting and marketing. As such, for IIROC registered firms, like ours, clients are protected equally, through the existing regulatory requirements and oversight to which their specific portfolio manager fulfils the fiduciary duty that they are subjected to. The prohibition on paying referral fees to non-registrants will likely disrupt investors' access to the investment services provided by investment firms that have primary business relationships with insurance agents, accountants, lawyers, financial planners and tax practitioners that they wish to continue utilizing and integrating into their wealth plan.

We find it unusual that the CSA has elected to recommend a cap on the referral fee amount and to also suggest a time-limit for payment. This does not seem consistent with prior statements and policies from the CSA where there has been no attempt to regulate price, assess value or impose a timeframe of the service relationship. We also would like to see the analysis used by the CSA in making such determination to illustrate the need for the cap and the rationale in establishing the time frame. We feel that the marketplace is best suited to establish pricing based on competitive practices and assessed value for the services provided.

We are also unclear what the difference is, in principle, between the selection of an investment manager who manages money in products or solutions for clients that provide for an ongoing service or trail fee in the pricing model (which there is no guidance on price level or payment timeframe) vs. the selection of an investment manager entering into a fully disclosed fee sharing arrangement with a client and a referral partner that has not structured their business model or investment solutions to utilize a service or trail fee concept to compensate for services of a third party with respect to a client relationship.

The proposed changes to referral arrangements are very broad and can have the effect of eliminating or limiting legitimate arrangements that currently operate to the benefit of investors. This can create the unintended consequence of reducing investor choice and access to registered discretionary portfolio managers who are held to a fiduciary standard when servicing the needs of investors. Given the potential impact of the proposed changes to referral arrangements on existing entrenched business models and the fact that this is the first time these proposals have been presented for public comment, we believe it would be beneficial to all parties involved, if the CSA moved the discussion, research and recommendations for referral arrangements into a separate work stream.

In the alternative, if a separate work stream is not considered necessary for the proposed referral arrangement guidelines, we recommend that the restriction on firms and registrants paying for referrals from non-registrants be removed where the partnering investment manager is subject to the fiduciary standard under its relationship established with the referral client. If the CSA continues to be concerned about the referral arrangements with non-registrants after its review of the Industry comments, then we further recommend that paid referrals continue to be permitted where the referring firm or individual is a non-registrant in the securities industry, but is a member of a self-regulatory or self-governing body, or industry where the activity is subject to regulation, conduct and ethical requirements, an example could be an individual working with an insurance firm, or an individual holding a Certified Financial Planner designation, or a designated tax and estate practitioner to name a few.

6. 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.

Given the time required to update all policies and procedures and disclosure documents, provide training, install systems to monitor and track securities, form new committees and review all the thousands of products the firm already utilizes or has on their shelf, 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.

With respect to referral arrangements, we recommend further public consultation be undertaken for the reasons provided above, based on the conclusions, an acceptable transition period would be recommended.

Should you have any questions or require additional information, do not hesitate to contact us.

Sincerely,

Charles R. Sims, FCPA, FCA
President & Chief Executive Officer