BY ELECTRONIC MAIL: comments@osc.gov.on.ca , consultation-en-cours@lautorite.qc.ca

October 19, 2018

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Authorité 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

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

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

Dear Sirs / Madames:

RE: Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP– Reforms to Enhance the Client-Registrant Relationship

Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") on the Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103") and Companion Policy 31-103CP Registration Requirements, *Exemptions and Ongoing Registrant Obligations* (the "CP") relating to Reforms to Enhance the Client-Registrant Relationship ("Client Focused Reforms") (collectively, the "Proposed Amendments").

Fidelity Investments Canada ULC ("Fidelity") is Canada's 4th largest mutual fund company managing approximately $132 billion in mutual fund and institutional assets.

For over 70 years, including 31 years in Canada, Fidelity has put investors first by working hard to help them achieve their financial goals. We recognize that the CSA is also committed to improving outcomes for investors and we are pleased to work collaboratively with the CSA toward our shared commitment.

GENERAL COMMENTS

Fidelity is very pleased with the CSA's proposals in the Client Focused Reforms. The CSA has struck the right balance in proposing a best interest standard for conflicts of interest. We are also very supportive of the increased focus on conflicts of interest with respect to proprietary products and compensation.

We know that the CSA is very mindful of the ultimate impact of regulatory reforms on investors. We agree that all investors should have access to a choice of appropriate investments which are easy to access and understand. As well, there needs to be a place for both smaller and larger dealers and advisors and different kinds of investments with varying features. We also believe in access to advice at a reasonable cost. In other words, access and choice must be fostered in order to have a healthy marketplace with the best outcomes for investors. This is the ideal that we all support. It is clear to us at Fidelity that the regulators have taken note of these principles and have listened to input from Fidelity and other industry members.

SPECIFIC COMMENTS

1. Conflicts of Interest

a. Support for Approach to Conflicts of Interest

Fidelity supports the proposal that conflicts of interest must be resolved in the best interests of clients. It addresses key regulatory and investor concerns without bringing the blunt instrument of an over arching best interest standard to all activities of registrants. It focuses on the most important issues which can impact investors negatively.

We would urge the CSA to give clear guidance around the resolution of conflicts of interest in the best interests of investors. We prefer to see concrete guidance in Instruments rather than regulation by enforcement, as we have seen more recently relating to certain conflicts. We would encourage the CSA to review how the Proposed Amendments in their final form are instituted by the industry and vigorously and actively monitor and perform reviews on an ongoing basis.

b. Support for Outcome on Embedded Fees

Fidelity strongly supports the CSA's proposed approach to embedded fees (apart from DSC fees, which we have addressed in past comment letters under the Mutual Fund Fees Reform project). We agree that embedded fees should not be banned and that they should be considered and addressed in light of potential conflicts of interest. We believe that it is very important to consider the investor's individual needs and choose the purchase option that best suits that investor. We expect this conflict to be mitigated through Proposed Amendments.

We do agree with the CSA that different types of fee models may be appropriate for different types of investors. In particular, we agree that embedded fees can be suitable for some investors, while fee-based accounts may be suitable for others. An unfortunate consequence of the embedded fee consultation has been that many dealers have moved to a high preponderance of fee-based assets on their platforms (in some cases the platform is entirely fee-based now with no other choices). There is evidence that some clients have been charged more when moved to a fee-based account than they were being charged with an embedded fee. And we have seen financial advisors struggle with what to do when their firm insists that all accounts be moved to a fee-based model which may not be suitable for some clients. We would encourage the CSA to give clear guidance on where a fee-based account is not suitable for a client, that a dealer and an advisor should not offer that account to that investor, even in circumstances where only fee-based accounts are offered on the platform. This should be an explicit part of the dealer's obligations, not just the advisor's. We think it should be incumbent upon dealers to review their clients' accounts to ensure that they have the most appropriate fee model for their clients.

Another unintended consequence of the move to fee-based accounts has been a significant increase in redemption rates for those accounts. For front load accounts, we see industry redemption rates in the range of 15%, but for fee-based accounts, the industry redemption rate is in the range of 25 to 30%. We doubt this makes sense for fee-based investors. As you are aware, the holding period for ETFs can be measured in days and sometimes hours. Staying the course in an investment for the longer term is often the best indicator of success for an individual investor. We would urge the CSA to give guidance relating to turnover in fee-based accounts and to avoid a focus on short-term performance for most clients where it is not appropriate. The holding of an investment should be commensurate with the time horizon of the client, obviously with continued vigilance around the quality and performance of that product.

2. Emphasis on Costs

Fidelity very much supports the philosophy that investors should understand the costs of the investments that they are buying and the impact of those costs on potential returns. However, we think the most important driver of investment success is performance, inclusive of costs. An over emphasis on costs without the context of performance or a consideration of a number of other factors may not result in the best investor outcomes. We urge the CSA to be clearer that the suitability analysis should include the consideration of a number of factors and that cost should be considered as an important factor for strong investor outcomes.

Based on what we consider a flawed reading of the paper, many in the industry are saying that the only, or most definitive driver, of a suitable product is cost. Many say it is <u>the</u> primary driver based on the wording of the Proposed Amendments. This is strongly reinforced by language that repeats "lower cost" or "lowest cost" in Annex E – Local Ontario Matters. The industry is reading the CP and Annex E together as if they provide the definitive guidance.

We know that it was not the CSA's intention to drive the investor to the cheapest product absent a thorough analysis of all of the benefits of the security being offered (and particularly performance and risk). We also know from members of the CSA that this project was not a "cost reduction project". We suggest this be made clear in the Proposed Amendments.

The third full paragraph on page 191 is where many believe the guidance requires the lowest cost.

> "....we expect the registrant to trade, or recommend, the lowest cost security..."

However, we believe that this paragraph needs to be read in light of the previous paragraph:

> "Registered individuals must put their clients first when selecting between **multiple suitable options** available to the client". [Emphasis added]

Further, on page 185, guidance is given on when a security is suitable and includes:

- the general structure and features of the security
- conflicts of interest including compensation
- the parties involved - including the issuer's financial position, history, viability, qualifications, reputation, track record of the parties involved (including the fund manager)
- risks
- performance

We think that all of these factors together give you the full picture. When choosing among multiple suitable options and taking into account the factors on page 185, cost must be overlaid.

We would recommend that you make this clearer and perhaps tie all of these pieces together explicitly in the CP in one place and in any other guidance provided to the industry.

Lastly, we would urge the CSA to make it clear that the “lowest cost” does not mean that clients need to be driven to passive ETFs. We know the CSA is aware of the dangers of a market heavily skewed toward passive ETFs and the potential for considerable investor consequences if that does occur. A healthy balance between active and passive products, as well as ETFs and mutual funds and other types of securities is important for a healthy functioning marketplace.

3. Support for Proprietary Product Approach

Fidelity strongly supports the guidance provided in the Proposed Amendments for the sale of proprietary products. We have seen a dramatic rise in the sale of proprietary products. In some cases, some dealers who hold themselves out as open-architecture have platforms that are upwards of 90% proprietary. There should be a strong incentive for those platforms to offer the best product for the investor, not the one that drives the most profits to their related parties or the firm itself.

We believe that the CSA should specifically focus on the conflict of revenue targets for proprietary products. Quite often, integrated firms set targets for the sale of proprietary products and these are then cascaded down to branch managers and advisors who are compensated at least in part by the amount of proprietary products sold and revenues generated. This conflict has been identified in the CSA proposal, but the notion that revenue targets should not exist based solely or in part on proprietary products should be clear. Dealers should be revenue neutral whether they sell proprietary or third party products and their ties to related party proprietary distribution should not impact their independence.

It is also very important that the determination of what products go on a proprietary shelf not be determined within the asset management divisions of integrated companies that sell proprietary products. It is a conflict to have those that are incented to offer proprietary products to related dealers decide whether or not to include third party products on the dealer shelf.

In addition, we are highly supportive of the notion of an independent review of proprietary shelves for parties that are related to asset managers who sell proprietary products. This kind of review is also required in Australia and has been quite successful at improving outcomes for investors and ensuring that the interests of investors are uppermost in the dealer's mind.

We also welcome and support the measures to curb incentives that disproportionately favour proprietary products. While it is clear in National Instrument 81-105 that such practices are not legal, it is clear (both from industry experience and from recent sweeps by the MFDA and IIROC) that both hard and soft incentives to sell proprietary products over superior third party products are or have been pervasive. It is time to end those practices.

We welcome the new equal access guidance in the Companion Policy. We at Fidelity have experienced much pressure from companies who sell proprietary products in overt and subtle ways. For example, advisors who sell Fidelity products in some cases are not allowed to attend information sessions on Fidelity products and wholesalers are not allowed to provide information to those advisors about Fidelity products even where their clients own Fidelity funds. Where companies claim to be open architecture, they surely should ensure that their advisors receive the information they need to make the best decisions possible for their investors. In addition, quite often, those firms are giving their own proprietary product asset managers full access to advisors while not allowing access to third party fund managers who are on the shelf.

For proprietary only firms, the new guidance would require those firms to consider how their products compare to third party products. However, the guidance does not go further to say what those firms should do if they find their own products are inferior to third party products or unsuitable for their investors. We think it is important that the guidance go the extra step to say what those firms should do in such a situation. For example, should those firms no longer sell those products or should they take active steps to improve them (repositioning them, changing portfolio managers, hiring independent third party subadvisors, etc.)? And should they cease selling those products until those measures are taken? Without additional guidance to say what closed shelves should do, we think the regulation will not be effective. In addition, because we expect some parts of proprietary firms (such as banks) to move to a fully closed shelf, this clear guidance will become even more critical to achieve positive outcomes for investors. It would be an unfortunate consequence of the Client Focused Reforms if more firms adopted closed shelves. But if they do, it is very important the CSA spell out the process for assessing their own products against third party as well as the consequences along with concrete actions that must be taken if the proprietary products are unsuitable by comparison to third party products.

Lastly, we would urge the CSA to be explicit in the Companion Policy about non-mutual fund securities. Although it is quite clear to us that the CSA intends to capture all securities, it does not appear to be thoroughly understood in the industry. We would urge you to make explicit a statement that the rules around conflicts and best interest apply equally to competing products like separately managed accounts and unified managed accounts and whatever else the industry creates in the future.

4. Support for Approach to Referral Fees

We are in agreement with the proposals relating to referral fees. We believe it is important for participants in the industry to be overseen by securities regulators. Appropriate monitoring and compliance with regulation is important for all participants. Investors deserve those protections.

Some in the industry argue that referral fees should be allowed in some cases - for lawyers or accountants in particular. We believe that an exemption for lawyers and accountants already exists in securities legislation.

We do not agree that portfolio managers or robo advisors should be allowed to assist advisors to give up their licenses while continuing to offer similar services. We strongly believe that all participants in our industry should be appropriately licensed and regulated. In addition, these models sometimes result in increased compensation to advisors and greater fees to investors. The advisor no longer has a dealer or the costs of the dealer infrastructure and compliance. We think this is fundamentally flawed and should not be permitted in a properly functioning securities regulatory regime.

5. Know Your Product (“KYP”), Know Your Client (“KYC”) and Suitability

One concern around the enhancements in KYP, KYC and suitability is whether the proposed requirements are scalable for large dealer firms but also whether it is possible for smaller dealers to comply considering the amount and complexity of the work required. We urge the CSA to consider both of these concerns through their deliberations.

a. Know Your Product (“KYP”) Obligations

We are supportive of the KYP guidance provided in the Proposed Amendments. However, we think it needs to be clear that dealers should take into account a variety of factors when considering what products to add to their shelves. It is important that dealers consider overall qualitative issues about both fund managers and the funds they offer. For example, ethical considerations, regulatory infractions, etc. might be an area that a dealer should consider when choosing products. Of course, dealers should not disproportionately consider cost over other factors like performance. A focus on outcomes for investors should be the most important criteria.

b. Know Your Client ("KYC") Obligations

We note significant enhancements in the obligations of representatives relating to the KYC obligations. We expect that the CSA will receive considerable comment in this area and will leave it to more knowledgeable industry participants to make those comments.

(i) Proposal for a Safe Harbour

We do think it could be useful to have definitive guidance and checklists through the SROs so that representatives understand their obligations. In addition, we would urge the CSA to consider a potential **safe harbour** for representatives who fulfill their obligations to clients and in compliance with NI 31-103.

We also think the CSA needs to recognize that there are some clients who will not be willing to update their KYC regularly or will not be willing to provide their full financial picture. As the CSA has said clearly, even holding a security is an investment decision. Where an advisor can demonstrate that he or she has done their utmost to fulfill this requirement, they should not be forced to give up the client. Likewise, the client should not be forced out of investments or the dealer firm. There should be a mechanism for the client to take responsibility for the information provided to advisors or to refuse to provide information as he or she sees fit.

(ii) Proposal for Permitted Clients

Fidelity recommends that the exemptions for KYC and suitability that apply to permitted clients that are not in a managed account should apply to all permitted clients without distinction for the investment vehicle used. The rationale for the extensive KYC and suitability requirements does not apply to sophisticated institutional clients. Institutional clients generally conduct a high level of due diligence before making an investment, employ both internal and external highly trained experts, understand the risk associated with investments, negotiate their own investment management agreements and are in a better position than registrants to understand their suitability needs. Alternatively, if all institutional investors cannot be exempt from the KYC and suitability requirements, then we respectfully submit that their KYC forms only need to be updated every five years unless there is a material change. Unlike individual investors, institutional clients do not experience major life changes like a marriage, divorce, birth, change in employment, etc.

c. Suitability

We are supportive of where the CSA has landed on suitability generally. We are curious about the definition of “client first” and would urge the CSA to give some guidance in that area. It is not a best interest standard in law, but is a new standard. We assume it simply means what the words say, but how that interpretation plays out practically is not clear. Clear guidance around the meaning of “client first” would therefore be useful.

6. Sales Practices as a Conflict of Interest

NI 31-103 with its draft amendments now explicitly applies to sales practices. NI 81-105 gives more specific and concrete guidance around sales practices. It is unclear how these two will intersect and how the CSA will audit relative to NI 81-105. It would be unhelpful if the CSA saw 31-103 as creating additional rules or a higher standard than 81-105 in the future. We would appreciate an explicit statement that 31-103 intends to identify sales practices as a conflict of interest which is mitigated by complying with NI 81-105.

7. Titles and Registration

Fidelity believes that there is an area relating to titles and registration that has not been addressed in the Proposed Amendments.

Currently, there is a category of registration called “portfolio manager”. This category encompasses a firm that is a portfolio manager as well as an individual. The individual category is called Portfolio Manager - Advising Representative. In the IIROC world, the registration category is called Registered Representative with Portfolio Management Capabilities (on the NRD system).

Fidelity is a registered and licensed portfolio manager. And it has individuals in a related company that are Portfolio Manager - Advising Representatives. Those individuals manage hundreds of millions and sometimes billions of dollars and have had extensive training to do so on behalf of investors. They start as research analysts and may continue in that capacity for their career, or may begin an extensive training process in order to become an associate advising representative and eventually a full advising representative. We and the industry call them “portfolio managers” (not advising representatives).

However, the same category of registration can be used by individuals who are given discretionary authority – so called "PM Licensed" individuals - either through the OSC or through IIROC. In most cases, these individuals have started out their career as financial advisors licensed with IIROC or the MFDA with training that is far different than those who start out to be research analysts and eventually portfolio managers such as those described at Fidelity above.

First, there is much confusion among the titles of these individuals and what their qualifications really are. And second there is much confusion about what the IIROC registration is versus the OSC registration. What is clear, is that many call themselves "portfolio managers" and sometimes "portfolio managers with discretion" or similar nomenclature.

We would argue that in order to avoid confusion for investors the PM licensed individuals who work for MFDA or IIROC firms, or individuals who do not work for licensed portfolio manager firms should have a different title and be registered in a different category from advising representatives who work for portfolio management companies. We believe that this would help eliminate confusion and assist investors in understanding the difference in qualifications and experience among these various categories.

We are also not sure why IIROC licenses discretionary portfolio managers. We believe that they should all be licensed by one securities regulator - at the provincial level - to ensure consistency and application of rules.

8. Transition

Fidelity supports the proposed transition with one exception. We think the conflicts of interest relating to proprietary products should be implemented sooner than two years after the final amendment. Investors who own third party funds should immediately, if not sooner, have the benefit of information about those products as well as access to the best products in the marketplace.

Certainly, compensation conflicts around proprietary products are already regulated clearly through NI 81-105, so there should be no need for any transition in that regard. But the CSA could and should provide a clear statement that the conflict is already regulated and the CSA expects full adherence now, not after a transition period.

9. Annex E - Ontario Local Matters

Annex E is intended to be a cost/benefit analysis as required by the Securities Act (Ontario).

However, we have seen industry members refer to Annex E as providing further guidance in addition to the Companion Policy.

First, Annex E sets out the OSC's five investor protection concerns. The language used in those are not directed at a cost/benefit analysis. We would suggest that re-stating these five concerns is not appropriate, considering that they were already addressed by the CSA in the various consultation papers. A cost/benefit analysis is not the place to restate concerns in language that has not been vetted and agreed to by the CSA.

Second, the number of instances where Annex E refers to driving lower cost products is amazing. While the CSA has told us that this project has not been a cost reduction exercise, the OSC continues to drive its agenda to achieve lowest cost as a regulatory standard, not lower cost in the context of multiple suitable options taking into account a variety of factors, including and most notably performance. In fact, the importance of performance is barely mentioned in Annex E.

We would suggest that Annex E be directly aimed at the costs and benefits of the proposal at hand without adding or enhancing guidance in the Companion Policy. We don't actually see much in the way of a definitive economic analysis in the Cost/Benefit analysis and would suggest that more attention be paid to a specific economic analysis.

10. Audits

Once the Client Focused Reforms become law, we would urge the CSA to conduct early and regular audits to reinforce the Reforms. As time goes by the understanding of the objectives of regulation seems to shift.

It is important that new regulations be reviewed early and on an ongoing basis in order to ensure that standards remain as the CSA expects. Of course, it is the industry's duty to adhere to the standards set out first and foremost, but as we have seen, that is not always the case as time goes on.

11. Regulatory Arbitrage

We would again urge the CSA to coordinate with their counterparts in the insurance industry. As standards rise in the securities world, we will see a migration of investors to less regulated industries. It is important that standards be harmonized across these worlds and that significant effort be given to helping governments understand the importance of high standards for all investors, not just those in the securities world.

12. Conclusion

Thank you for allowing us to provide comments on this very important initiative. We also thank you for considering our comments. We are, of course, always available to discuss our comments.

Yours very truly,

Fidelity Investments Canada ULC

"Rob Strickland"

Rob Strickland
President

c.c. Sian Burgess, SVP, Fund Oversight