September 28, 2016

Josee Turcotte, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

and

Me Anne-Marie Beaudoin,
Directrice du Sécretariat
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Re: Response to CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives toward their Clients (the Consultation Paper)

Dear Sir and Madam:

The National Exempt Market Association (NEMA) appreciates the opportunity to comment on the proposed regulatory best interest standard and targeted reforms to address investor protection concerns in the Canadian Financial services industry.

General Comments

NEMA has read the CSA's proposal with interest, and has some general comments before answering the specific consultation questions put forth in the Consultation Paper. Overall, we do not support the proposed regulatory best interest standard, but support some of the proposed targeted reforms.

Theoretically, a regulatory best interest standard is a good idea and would not change most Advisors daily routines as it is policy that this standard already exists for Certified Financial Planners,[1] Investment Dealer Registrants,[2] Mutual Fund Registrants,[3] Chartered Financial Analysts,[4] and Insurance Agents.[5] It is just not mandated in common law. It was revealed in a recent study that 70% of investors thought their advisor had a fiduciary responsibly,[6] most likely because their advisor thought so as well.

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[1] FPSC Financial Planners Code of Ethics (for CFP designation) Rules 101 and 202, http://www.fpsc.ca/sites/default/files/documents/Code_of_Ethics_April_2005.pdf
[2] Canadian Securities Institute CSC course (for IIROC licensing) Volume 1, Chapter 3, p. 15
[3] Mutual Fund Dealers Association, Business Conduct, Rule 2, http://www.mfda.ca/regulation/Rule2.html
[4] CFA Code of Ethics and Standards of Professional Conduct p. 2 http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n14.1
[5] Code of Ethics for Life Insurance Agents in Ontario p.1 http://www.fsco.gov.on.ca/en/insurance/lifehealthbulletins/Archives/Documents/CodeofEthics.pdf
[6] Investor Behavior and Beliefs: Advisor relationships and investor decision-making study. Investor Education Fund. 2012. http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf

However, in practise, if enacted as proposed the regulatory best interest standard could increase the complexity of regulation, increase litigiousness, significantly increase compliance costs, and errors and omissions insurance costs as well. None of these outcomes are beneficial for the industry or for the investor. Our general concern is that there is no consensus, or greater vision, amongst Canadian securities regulators on best interest reform. This will ultimately lead to increased complexity of regulation and increased costs of following those regulations. Advisor standards should be harmonized across registrant categories, especially when firms and registrants can operate in multiple jurisdictions. Our member Exempt Market Dealers have made great strides over the relatively short period since implementation of NI 31-103 to ensure suitability and advisory competency guidelines are met and exceeded, and currently follow CSA Staff Notice 31-336: *Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations*.

While we recognize that this is ultimately an initiative attempting to enhance investor protection, we caution regulators to not forget that a fundamental component of protecting all consumers is adequate and fair competition. There has been a relatively fast pace of change in regulation in the financial markets (most recently CRM II) and such onerous regulation procedures put independent firms and brokerages at risk as they do not have the economies of scale to absorb these continually increasing costs. This is in stark contrast to larger firms and chartered banks, whom are ultimately the beneficiaries of the shrinking number of independent financial services firms in Canada as consumers are left with fewer and fewer choices.

In the next section NEMA will address the specific questions on the CSA's proposed targeted reforms, as we feel these are a better strategy than the regulatory best interest standard.

NEMA Answers to Specific Consultation Questions

Area 1: Conflicts of Interest – General Obligation

1) Is this general approach to regulating how registrants should respond to conflicts optimal? If not, what alternative approach would you recommend? 2) Is the requirement to respond to conflicts "in a manner that prioritizes the interest of the client ahead of the interests of the firm and/or representative" clear enough to provide a meaningful code of conduct? If not, how could the requirement be clarified? 3) Will this requirement present any particular challenges for specific registration categories or business models?

As a caveat to our answers: conflicts of interest are unavoidable, and are prevalent to some degree in any industry. NEMA would also like to refute the general assumptions put forth by the research of the ineffectiveness of the disclosure model for Advisors by Cain, Loewnstein and Moore.[7] We agree that firms should communicate their conflicts of interest and 'have a reasonable basis' for concluding they have been understood by the client.

Although the idea of proposed regulation of putting "the clients' interests ahead of the interests of the firm and/or representative;" of excellent value, it would be very difficult to regulate because it is too broadly stated, and any business in any industry would find this rule unworkable in daily practice. If it is

[7] Please refer to Exempt Edge article in Issue 14: http://www.exemptedge.com/the-debated-impotence-of-disclosure/

compensation structure that is of greatest concern, meaning that an Advisor recommends product A over product B in every circumstance because it pays double the commission, then specific guidance should be written to address that. We applaud the efforts of IIROC to expand their Dealer Member Rule 42 to better address the compensation conflict of interest issue.

Area 2: Know Your Client (KYC)

4) Do all registrants currently have the proficiency to understand their client's basic tax position? Would requiring collection of this information raise any issues or challenges for registrants or clients?

Dealing representatives (DRs) would have the basic proficiency to understand the retail client's basic tax situation, assuming the client fully and accurately disclosed it. However, if the client is high net worth (HNW) or ultra-high net worth (UHNW), the complication of their tax situation increases, and may be beyond the DRs Proficiency.

5) Should the CSA also codify the specific form of the document, or new account application form, that is used to collect the prescribed KYC content?

NEMA has discussed the benefits of a standardized KYC form with certain Canadian regulators in the past. It was communicated to NEMA that the reason why an industry standardized KYC form could not be used is that KYCs are specific to the business model (not the client). We believe a KYC should be specific to the client, not the firm, and should be a client centric form. Adding prescribed content to CSA Staff Notice 31-336 would be beneficial.

6) Should the KYC form also be signed by the representative's supervisor?

No. We consider this proposal impractical, as it could hold up trades or subscriptions as the supervisor is generally not in the same physical place as the Advisor and client.

Area 3 – Know Your Product (KYP) – Dealing Representative (DR)

7) Is this general approach to regulating how representatives should meet their KYP obligation optimal? If not, what alternative approach would you recommend?

The proposed general approach to KYP seems intuitive. In the DRs understanding and consideration of the exempt products they sell, it is recommended that qualitative efforts (interviews with management, due diligence trips) be given consideration over the more formalized quantitative training that may be seen in bigger public brokerages.

Area 4 – Know Your Product (KYP) – Exempt Market Dealer (EMD)

8) The intended outcome of the requirement for mixed/non-proprietary firms to engage in a market investigation and product comparison is to ensure the range of products offered by firms that present themselves as offering more than proprietary products is representative of a broad range of products suitable for their client base. Do you agree or disagree with this intended outcome? Please provide an explanation. 9) Do you think that requiring mixed/nonproprietary firms to select the products they offer in the manner described will contribute to this outcome? If not, why not?

EMDs have all three types of models: proprietary, mixed and non-proprietary. It is understandable how this proposal could be more demanding for mixed and non-proprietary providers. It could lead to a bias towards proprietary product shelves, with less exotic and more generic products, as that would make managing the compliance risk easier.

10) Are there other policy approaches that might better achieve this outcome?

At this time, NEMA has no specific policy suggestions to amend this flaw in the proposal, other than to say the policy should be applied fairly with the same rigor to all three EMD models.

11) Will this requirement raise challenges for firms in general or for specific registration categories or business models? If so, please describe the challenges.

Yes, this requirement will raise challenges. In the EMD space, product comparisons and knowing the product 'universe' is more challenging, as there are no secondary markets, research resources, or benchmarks, so the application of this proposal wording could acknowledge that point to be pragmatically applied.

12) Will this requirement cause any unintended consequences? For example, could this requirement result in firms offering fewer products? Could it result in firms offering more products? 13) Could these requirements create incentives for firms to stop offering non-proprietary products so that they can fit the definition of proprietary firm?

Yes, it could. As stated in answer 8: It could lead to a bias towards proprietary product shelves, with less exotic and more generic products, as that would make managing the compliance risk easier.

14) Should proprietary firms be required to engage in a market investigation and product comparison process or to offer non-proprietary products?

As mentioned in answer 10; it would be ideal if the proposed rules be applied fairly with the same rigor to all three EMD categories: proprietary, mixed and non-proprietary; not just mixed and non-proprietary. NEMA is concerned about the Pandora's Box of extra time and resources this may place on all firms.

15) Do you think that categorizing product lists as either proprietary and mixed/non-proprietary is an optimal distinction amongst firm types? Should there be other characteristics that differentiate firms that should be identified or taken into account in the requirements relating to product list development?

No comment.

Area 5: Suitability

16) Do you agree with the requirement to consider other basic financial strategies?

Yes, it is prudent that the DR consider other financial strategies. However, that means their role would be better described as an 'advisor' than a 'salesperson'.

17) Will there be challenges in complying with the requirement to ensure that a purchase, sale, hold or exchange of a product is the "most likely" to achieve the client's investment needs and objectives?

The proposals are well intended, but again, the interpretation of 'most likely' could be problematic, when recommendations are basically educated guesses, and the outcome of all financial products (even GICs when you factor in inflation and currency fluctuations) are unknown.

18) Should there be more specific requirements around what makes an investment "suitable"?

Some additional guidance in the CSA staff Notice 31-336 around concentration could be useful after a consultation on risk classification in the exempt market, as all products are classified as high risk when in reality they range from mid to high risk. This would potentially create more accurate suitability models.

19) Will the requirement to perform a suitability assessment when accepting an instruction to hold a security raise any challenges for registrants?

If both an action and an inaction are regulated, then the interpretation could apply to all possibilities, so that could be problematic. In the exempt market space, there is really usually only an action around the purchase or subscription of the product. Then it generally must be held and not sold. Therefore, suitability in the exempt market could be focused on the purchase and portfolio construction.

20) Will the requirement to perform a suitability analysis at least once every 12 months raise challenges for specific registrant categories or business models? For example, a client may only have a transactional relationship with a firm. In such cases, what would be a reasonable approach to determining whether a firm should perform ongoing suitability assessments?

It could raise challenges in two main ways. First, it could be problematic for orphaned accounts where the DR has left the business or EMD. In addition, not all clients want to meet every twelve months to do compliance paperwork, especially if they invested in longer term projects. These clients will come in when they deem it necessary and important, which is when the updating can be done. Thirdly, rebalancing the exempt market portion of the portfolio can be problematic as private securities have limited resale and redemption opportunities.

21) Should clients receive a copy of the representative's analysis regarding the client's target rate of return and his or her investment needs and objectives?

It is ideal that the client have access to this, mandating it seems unnecessary as they get a copy of the KYC form.

22) Will the requirement to perform a suitability review for a recommendation not to purchase, sell, hold or exchange a security be problematic for registrants?

As in answer 19, if actions and inactions are regulated, then the interpretations could apply to all possibilities, so that could be problematic. Again, in the exempt market space, there is really usually only an action around the purchase or subscription of the product. Then it generally must be held and not sold.

Area 6: Relationship Disclosure

23) Do you agree with the proposed disclosure required for firms registered in restricted categories of registration? Why or why not?

The application of the proposed disclosure required for 'firms registered in restricted categories' could be problematic, as registration categories are an intellectual and artificial concept placed on firms for the purpose of regulation. To a client, an investment is an investment, and they work with dual licensed firms, Advisors, or partnerships to get their needs met. If this proposed rule is to be applied, it should be applied to all firms regardless of registration category.

24) Do you agree with the proposed disclosure required for firms that offer only proprietary products? Why or why not?

The proposed disclosure seems reasonable, but the interpretation of this proposal could be problematic.

25) Is the proposed disclosure for restricted registration categories workable for all categories identified?

Please refer to the answer to 23.

26) Should there be similar disclosure for investment dealers or portfolio managers?

No comment.

27) Would additional guidance about how to make disclosure about the relationship easier to understand for clients be helpful?

A guidance in the form of text examples as best practices could be helpful.

Area 7: Proficiency

28) To what extent should the CSA explicitly heighten the proficiency requirements set out under Canadian securities legislation?

There is very little knowledge of exempt market products by Advisors outside our registrant category. We support the CSAs efforts to add that to Division 2 of Part 3 of NI 31-103.

There is no continuing education proficiency requirements for DRs currently for their exempt market license. NEMA would be open to discussions with regulators on this issue. NEMA is a firm believer in continuing education, but would like a structure that enhances the Advisor, and does not turn into a 'tax' on DRs as has been witnessed in other sectors of the financial services industry.

29) Should any heightening of the proficiency requirements for representatives be accompanied by a heightening of the proficiency requirements for CCOs and UDPs?

We have no comment at this time.

Area 8: Titles

30) Will more strictly regulating titles raise any issues or challenges for registrants or clients?
31) Do you prefer any of the proposed alternatives or do you have another suggestion, other than the status quo, to address the concern with client confusion around representatives' roles and responsibilities?

Out of the three scenarios, none are ideal, but the third option, using 'Dealing Representative,' is the most practical, as we call Dealing Representatives by their category currently. However, Advisor or Private Wealth Advisor, Private Security Specialist are currently commonly used and seem to more clearly reveal what the Advisor does than the registrant category. All regulatory categories could be considered 'Financial Advisors.'

Out of the three alternatives given, the second option, 'Securities Salesperson,' is the least desirable. Dealing Representatives have proficiency requirements, standards or professionalism they need to adhere to. Also, they give suitability advice, and should this proposal be implemented they will also be expected to give advice on alternative financial strategies to investing (like cash flow and debt repayment).

An alternative one does not seem practical either, as portfolio managers do not call themselves advisors, but 'portfolio managers.' In addition, We do not see the title 'restricted securities advisors' appealing to either the DRs or the clients.

32) Should there be additional guidance regarding the use of titles by representatives who are "dually licensed" (or equivalent)?

Yes, that would be helpful, as many Dealing Representatives are dually licensed.

Area 9: Designations

33) Should we regulate the use of specific designations or create a requirement for firms to review and validate the designations used by their representatives?

We do not feel there is enough information in Appendix G to comment.

Area 10: Role of UDP and CCO

34) Are these proposed clarifying reforms consistent with typical current UDP and CCO practices? If not, please explain.

No comment.

Area 11: Statutory Fiduciary Duty when Client Grants Discretionary Authority

35) Is there any reason not to introduce a statutory fiduciary duty on these terms?

No comment.

Concluding Remarks

Although the regulatory best interest standard is well intended, it would not be practical and would increase regulatory disparity, as well as increase cost burdens on registrants and their clients. Alternatively, the CSA should focus policy changes on their major area of concern: potential conflict in remuneration structures. In addition, delaying the regulatory best interest standard would give time for regulators to see if the CRM II and other related changes are having the desired effects on industry. It would also give time to see how similar proposed changes internationally effect larger markets like the US, UK, and EU, and pick up specific knowledge from those changes before implementing potentially impractical changes to firms in Canada. NEMA supports most of the targeted reforms, as discussed above, but hold particular contention to the job titles proposal. NEMA agrees with the BCSC's arguments in the proposal, that the targeted reforms are adequate at this point in time.

If you would like further elaboration on NEMA's comments, please feel free to contact Cora Pettipas at cora@nemaonline.ca.

Regards,

National Exempt Market Association

"Signed"	"Signed"
Craig Skauge President, NEMA	Cora Pettipas Vice President, NEMA

CC:
British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut