September 29, 2016

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
The Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan

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Dear Sirs/Mesdames:

Re: CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives towards their Clients*

The Private Capital Markets Association of Canada (the "**PCMA**") is pleased to provide our comments in connection with the Canadian Securities Administrators' ("**CSA**") Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives towards their Clients* (the "**Consultation Paper**") as set out below.

What is the PCMA?

The PCMA is a not-for-profit association founded in 2002 as the national voice of exempt market dealers ("**EMDs**"), issuers and industry professionals in the private capital markets across Canada.

PCMA plays a critical role in the private capital markets by:

- assisting its hundreds of dealer and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in-depth educational opportunities to private capital markets professionals;

- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies, other industry associations and public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at www.pcmacanada.com.

PCMA Consultation Process

The PCMA consulted with its members to gather input into preparing and finalizing this comment letter. This included:

- a detailed presentation to the PCMA board of directors and striking of a working group to collect information from members and draft PCMA's comment letter;
- two webinars to PCMA members based on the presentation to the board and information sessions held by the OSC;
- in person meetings with members in Montreal, Toronto, Calgary, and Vancouver to obtain further input to respond to the questions in the Consultation Paper;
- circulation of PCMA's draft comment letter to the executive committee and interested members to obtain written feedback;
- in person and call-in meeting with membership to receive final drafting comments; and
- circulation of the penultimate letter to the PCMA board of directors in September.

This letter reflects the comments and input from all those who attended, participated and provided meaningful feedback and comments. The first section of the letter presents our general comments on the overall the Consultation Paper, followed by comments on the specific proposed targeted reforms, and finishes with our comments on the proposed regulatory best interest standard. We have answered the questions in the Consultation Paper grouped by topic and not numerical order. As a result, you will notice the question numbers are not sequential as questions relating to the same topic are asked in both the framework section and the appendices of the Consultation Paper.

GENERAL COMMENTS

Significant Regulatory and Industry Reforms

The CSA explains that the purpose of the Consultation Paper is to make certain requirements in National Instrument 31-103 *Registrant Requirements, Exemptions and Ongoing Registration Obligations* ("**NI 31-103**") more explicit. The CSA notes the proposed reforms "… are intended to work together to improve the client-registrant relationship"[1] and "better align the interests of registrants to the interests of their clients and enhance various specific obligations that registrants

[1] (2016), 39 OSCB 3957

owe to their clients."[2] These goals are aspirational and the outcomes amorphous resulting in uncertainty for registrants and investors.

The phrase "proposed reforms" sounds like revisions and tweaks to existing rules and regulations. However, the Consultation Paper proposes a complete overhaul and reworking of the key provisions of securities regulation including Know Your Client ("**KYC**"), Know Your Product ("**KYP**") and suitability. The PCMA is concerned with the replacement of key components of KYC, KYP and suitability with new concepts. Similarly, the proposals related to conflicts of interests introduce new tests.

A common complaint by registrants in all categories of registration is the regulators "don't understand the business". The creation of completely new and untested standards through the proposed targeted reforms rather than tweaking and enforcing the current rules seems to support that sentiment.

Gaps in the Consultation Paper

The areas of additional prescription are identified in Part 4 of the Consultation Paper. Part 7 of the Consultation Paper discusses the proposed framework for the proposed targeted reforms. Reference is also made to appendices which contain descriptions of potential guidance relating to certain proposed targeted reforms. The Appendices of the Consultation Paper provide more details of the proposed targeted reforms through the proposed guidance.

We feel, there are material gaps between the explicit requirements in Part 4, the framework in Part 7 and the details in the Appendices. Based on the detail in the Appendices some of the targeted reforms are not amendments and clarification rather they are replacing customary, usual and compliant practices in the industry with new concepts that have no history of use in the industry. We believe these gaps will make it difficult for industry participants to properly implement any suggested reforms, and undermine the Consultation Paper's goal of clarifying the regulatory regime.

Moreover, the CSA provides no information on what efforts it will take to assist registrants in understanding and implementing the targeted reforms. We respectfully submit that compliance can be improved if the CSA works more collaboratively with registrants in providing more education and guidance involving certain matters, including certain targeted reforms, instead of assuming registrants have the know-how, expertise and resources (including financial) to implement such changes.

Lack of Consensus

The Consultation Paper sets out the serious disagreement among CSA members in connection with the regulatory best interest standard. The lack of harmonization among CSA members does not provide for fair and efficient capital markets. Any patchwork regulation significantly drives up the cost of compliance and increases the risk of unintentional non-compliance with unknown and varying standards. This type of regulatory framework is not in the best interest of the capital markets, registrants or investors.

[2] (2016), 39 OSCB 3947

Given the lack of consensus among the CSA, we strongly encourage engaging in additional research and obtaining greater consensus before making a significant regulatory change such as introducing a regulatory best interest standard. This is critical for the proper functioning of Canada's capital markets.

The Return to Prescriptive Regulation

The Consultation Paper is a step backwards in modern regulation, as the proposed reforms involve a shift away from our current principles-based regulatory regime, and back to prescriptive regulation. This shift away from principles-based regulation is particularly harmful to smaller registrants, such as EMDs, as a prescriptive regulatory regime is ill-suited to their unique role in Canadian capital markets.

The Canadian securities regulation regime has consciously evolved towards principles-based regulation. In 2007, the CSA articulated the rationale for shifting to a principles-based compliance regime in its first draft of National Instrument 31-103 – *Registration Requirements*:

> "Compliance is a firm-wide responsibility. We have sought to reinforce firm-wide responsibility by setting out a general compliance obligation in the Rule. Registered firms must establish and enforce a system of controls and supervision that ensures the firm's compliance with all applicable requirements of securities legislation. These are not new requirements. However, the Rule adopts a principle-based approach to these requirements because experience suggests that this is a ***better way to accommodate the diversity in size and scope*** of our industry participants." [emphasis added][3]

The CSA fully embraced principles-based regulation when it introduced and further amended NI 31-103. The implementation of this principles-based regulatory regime involved some challenges as recognized by IOSCO. In its 2009 report, *Guidelines to Emerging Market Regulators Regarding Requirements for Minimum Entry and Continuous Risk-Based Supervision of Market Intermediaries*, the IOSCO commented:

> "…the implementation of risk-based supervision is not without challenges. Some of the challenges identified relate to the skills gap of regulatory staff; ability to identify and define relevant risk types and risk mitigants; obtaining comprehensive risk profiles of capital market intermediaries; subjectivity involved in determining risk scores; and applying a consistent risk rating methodology across all financial institutions. Regulators will have to build capacity to address these challenges."[4]

These challenges remain relevant today, and would be exacerbated by the implementation of a prescriptive regulatory regime.

The move away from principles-based regulation is particularly problematic for smaller registrants, many of which are members of the PCMA. The flexibility and proportionality of principles-based regulation allows small firms to be compliant in a manner commensurate with the risks of their business activities.

[3] (2007) 30 OSCB (Supp-2), p. 13

[4] (2009) IOSCO, p. 4

Implementing a prescriptive regulatory regime does not result in increased protection for investors. The prescriptive requirements may be better for large firms with a large compliance staff and easier for regulators to enforce. However, there is no evidence that more prescriptive regulation offers better protection for investors or achieves the desired regulatory outcomes.

Striking the Right Balance

As stated above, CSA members have the dual mandate under securities legislation of investor protection and promoting fair and efficient capital markets. The PCMA believes the pendulum has swung far away from striking the right balance between investor protection and fostering fair and efficient capital markets and does not reflect commercial reasonableness or market realities. Certain targeted reforms, and most definitely the best interest standard, appear to make the registrant solely responsible for investment losses without any responsibility being placed on investors or issuers.

The CSA has neglected to focus on investor protection through investor education and empowerment. The Consultation Paper does not provide any action plan focusing on investor education or empowerment for investors to learn more about investing and what investors should expect and not expect from a registrant. The targeted reforms will not change this issue and will foster an environment that places undue, if not complete, reliance on registrants creating misplaced trust and discouraging investors from taking action to educate themselves about their investment decisions.

We note that IOSCO states in its principles of regulation that “regulation should not be expected to remove risk from the capital markets, but it should ensure proper management of that risk”. The PCMA suggests this means that investors should be in a position to protect their own interests by making an informed investment decision. The PCMA believes that the outcome of some of the proposed targeted reforms appears to be aimed at protecting investors from their own judgment at the expense of registrants.

The Unique Business Model of Exempt Market Dealers

Many of the targeted reforms and the best interest standard do not reflect the transactional nature of the business undertaken by EMDs. In some cases they engage in corporate finance and capital advisory services; and in other cases they present an array of issuers and investment products allowing investors to diversify their investment portfolio. Simply put, EMDs are intermediaries engaged by issuers and investors to make a private placement of securities.

Issuers seek out EMDs to sell their securities in connection with a private placement offering and EMDs solicit qualified investors. This is no different than the corporate finance group at an investment bank or IIROC dealer. The dealer is engaged by the issuer and the corporate finance group structures, prepares and approves the issuer for marketing. The dealing representatives are trained and then go out and speak to potential investors about that one product.

An EMD may offer a number of investment products including investment products from related issuers. In this case, the EMD may also seek out issuers to add to its product offerings. The EMD will conduct its due diligence on the products and train the dealing representatives who meet

with potential investors about the different investment products that are available. The investor may buy securities from the EMD if there is a suitable investment.

EMDs are not responsible for financial planning, taxation advice or creating investment portfolios except in the context of a transaction. This is reflected in the current Exempt Market Proficiency Course (the "**EMP Course**"). Accordingly, the PCMA reminds CSA members that the private capital markets are different than the public capital markets. Our members vary in size, industry specialization and geographic scope. Some are issuers, some may represent a significant number of issuers at a time, some may represent only one issuer at a time and some will go for periods representing no issuer. The targeted reforms, if implemented, must be done with awareness of the various business models and types of registrants involved. A 'one-size fits all' approach could have deleterious effects on registrants, investors and the capital markets.

SPECIFIC COMMENTS

Conflicts of Interest

General Comments

The PCMA supports the CSA's objective of aiming to avoid and control material conflicts of interest in such a manner that prioritizes the client's interests ahead of the interests of the dealer and/or dealing representative.

The PCMA believes that there will always be inherent conflicts of interest due to a dealer's product mix which are unavoidable. By virtue of their registration category, EMDs are limited to selling products in the private capital markets. There are instances where an EMD's client is both the issuer and the investor. These products may not be in the best interests of the investor to purchase, and may include certain proprietary products providing additional compensation to the issuer, dealer and its representatives.

The PCMA agrees that disclosure of a material conflict of interest should be prominent, specific and clear and should be sufficiently meaningful so that the client fully understands the conflict of interest. We also appreciate that disclosure of a material conflict of interest may not, in and of itself, be sufficient to discharge a registrant's duties in all instances. However, the Consultation Paper offers little guidance on the level of disclosure needed to discharge a registrant's duty to disclose conflicts of interest to their clients.

The PCMA is concerned that prominent, specific and clear disclosure, coupled with a signed acknowledgement from an investor, may not fully satisfy the regulatory requirements. For example, if a dealing representative discussed a material conflict with the client and identified the disclosure relating to the conflict in the offering document, has the 'sufficiently meaningful test' been satisfied? If not, what exactly must be done to discharge this duty?

Further, the CSA is proposing a 'reasonable basis test'. This is a new requirement, where registrants must have a reasonable basis for concluding that a client fully understands the implications of a disclosed conflict of interest. We believe there are several problems with this proposal. The CSA has highlighted a significant concern around the financial literacy of investors. Clients are not always forthcoming with their understanding of investment products

and may say they understand and sign off even when they don't; therefore, having a client sign a conflict of interest disclosure form may not be enough to satisfy a reasonable basis test. The Consultation Paper provides no additional guidance as to what factors must be considered by registrants to meet the reasonable basis test. Without further guidance, registrants may have challenges demonstrating compliance with the requirement to regulators.

The PCMA would support efforts by the CSA to engage the appropriate government ministries to encourage financial literacy becoming part of the education curriculum. The PCMA applauds the effort of the AMF with their launch of a new financial literacy project "Talking money in class!" which is aimed at teachers at all levels of education to encourage discussing financial issues in classrooms. Financial literacy among Canadians clearly needs to be addressed across the country. However, the PCMA does not believe that putting the onus on registrants to compensate for the current lack of financial literacy is the correct approach.

Responses to Questions

1) Is this general approach to regulating how registrants should respond to conflicts optimal? If not, what alternative approach would you recommend?

The PCMA is of the view that there is insufficient guidance from the CSA regarding what constitutes a material conflict of interest or about the specifics as to what disclosure is required in the event a material conflict of interest exists. The PCMA supports the CSA's objective of aiming to avoid and control material conflicts of interest in such a manner that prioritizes client's interests. However, we are concerned the proposed general framework does not provide guidance on how registrants should handle material conflicts of interests that will stand up under scrutiny in a compliance review.

We recommend guidance within the companion policy to NI 31-103 ("**31-103CP**") include examples of identified material conflicts of interest that requires a registrant to respond in a manner which prioritizes the interests of the client ahead of the interests of the firm and representative. We recommend the use of a "Conflicts of Interest Disclosure Form" (the "**COI Disclosure Form**"). The CSA could specify the types of material conflicts of interest (i.e. product mix, relationship disclosure, compensation structure, etc.) to be set out in the COI Disclosure Form. The COI Disclosure Form would be used to acknowledge discussion of conflicts of interest and understanding by the client and the dealing representative of the EMD.

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?

The PCMA is of the position that EMDs should respond to material conflicts "in a manner that is in the interest of the client", and that the term "prioritize" should be removed. The PCMA takes issue with term prioritize as it suggests that the registrant must act for a client with a focus solely on what's best for the client, without considering any impact to the registrant's relationships, reputation or business.

3) Will this requirement present any particular challenges for specific registration categories or business models?

The PCMA believes that this requirement will present challenges for EMDs who often do not have an ongoing relationship with a client but a transactional relationship. As noted above, many EMDs may have a relationship with both the issuer and the investor. In these instances, we don't believe that one client should be prioritized over another. Each client should be treated honestly, fairly and in good faith.

44) Is it appropriate that disclosure by firms be the primary tool to respond to a conflict of interest between such firms and their institutional clients?

Yes, subject to our comments below on the definition of an institutional client. Institutional clients are sophisticated investors and have the knowledge and industry experience to make an informed investment decision. Institutional clients understand the risks inherent when making investment decisions, and are well versed in identifying the severity of a conflict of interest if disclosed by dealers and their representatives.

45) Are there other specific situations that should be identified where disclosure could be used as the primary tool by firms in responding to certain conflicts of interests?

Accredited Investors as defined by National Instrument 45-106 *Prospectus and Registration Exemptions* ("**NI 45-106**") are sophisticated investors and have the knowledge and industry experience, or can gain access to professionals with the knowledge or industry experience, to make an informed investment decision. Accredited Investors understand, or can gain access to professionals that understand, the risks inherent when making investment decisions, and are well versed in identifying the severity of a conflict of interest if disclosed by dealers and their representatives.

46) Is this definition of "institutional client" appropriate for its proposed use in the Companion Policy? For example: (i) where financial thresholds are referenced, is $100 million an appropriate threshold?; (ii) is the differential treatment of institutional clients articulated in the Companion Policy appropriate?; and (iii) does the introduction of the "institutional client" concept, and associated differential treatment, create excessive complexity in the application and enforcement of the conflicts provisions under securities legislation? If not, please explain and, if applicable, provide alternative formulations.

The PCMA does not recommend the addition of the definition of an institutional client. The definition of an institutional client as proposed is substantially similar to the definition of a Permitted Client in NI 31-103. The difference is in the removal of individual Permitted Clients and the addition of financial thresholds.

We are unsure as to why financial thresholds are referenced and suggest that the implementation of thresholds would be inappropriate in certain cases. For example, under the proposals in the Consultation Paper a pension fund that is regulated by the Office of the Superintendent of Financial Institutions with net assets of $99 million would not meet the requirement to be

considered an "institutional client", however, a registered firm with net assets of $5 million would be considered an "institutional client". We do not understand how the addition of monetary thresholds or the removal of individuals from the definition of a Permitted Client increases a person or company's understanding of conflicts of interest.

The PCMA feels that the addition of another category of investor will increase the complexity of the application of the conflicts of interest provisions under securities legislation.

47) Could institutional clients be defined as, or be replaced by, the concept of non-individual permitted clients?

We do not agree with creating a second type of Permitted Client. There are only two definitions of permitted client that are individuals: registrants and former registrants, and individuals with financial assets of $5 million. In each case these individuals should be considered 'professional investors' who are aware of the risks associated with investing and have the capacity to understand the impact of the conflicts of interest disclosure.

48) Are there other specific examples of sales practices that should be included in the list of sales practices above?

Other specific examples of sales practices that may be considered include:

- Paying for or making reimbursement of costs or expenses incurred by a registrant for the general marketing and promotional expenses or the overhead costs of a dealer or individual representative. Events that fall within these parameters may include client appreciation events or client mailings which are general in nature.
- A charitable donation or sponsorship made at a registrant's request.
- Paying for or making reimbursement of costs or expenses incurred by a registrant for a conference or seminar that is organized by the registrant.

49) Are specific prohibitions and limitations on sales practices, such as those found in NI 81-105, appropriate for products outside of the mutual fund context? Is guidance in this area sufficient?

Prohibitions and limitations on sales practices as found in NI 81-105 may be appropriate for products which are investment funds sold under prospectus exemptions. The conflicts of interest for these types of products would be similar to a mutual fund that is a reporting issuer sold under a prospectus or simplified prospectus. This would help avoid the potential for regulatory arbitrage regarding sales practices surrounding investment funds that currently exists between a mutual fund offered under a prospectus or simplified prospectus and an investment fund offered under a prospectus exemption. Similar to NI 81-105, the CSA may want to consider the prohibition and limitations on sales practices to be applicable to issuers who are registered as investment fund managers and are regulated by the CSA.

50) Are limitations on the use of sales practices more relevant to the distribution of certain types of products, such as pooled investment vehicles, or should they be considered more generally for all types of products?

The PCMA does not view all products as fungible. See also response to Question 49 above.

51) Are there other requirements that should be imposed to limit sales practices currently used to incentivize representatives to sell certain products?

The PCMA feels that the disclosure of material conflicts of interest for a registered dealer should include sales practices and is sufficient. It is common practice for registrants to have a code of ethics and policies to deal with gifts and entertainment similar to companies that are in other lines of business.

52) What type of disclosure should be required for sales practices involving the distribution of securities that are not those of a publicly offered mutual fund, which are already subject to specific disclosure requirements?

See response to Question 51 above.

53) Should further guidance be provided regarding specific sales practices and how they should be evaluated in light of a registrant's general duties to his/her/its clients? If so, please provide detailed examples.

See response to Question 51 above.

Know Your Client

General Comments

While the Consultation Paper refers to aligning client interests and to undefined expected outcomes, the purposes of the KYC requirements are well-known. The collection of KYC information provides registered firms and their representatives with information to:

- Assess the suitability of a recommended investment for a client;
- Determine the reputation of a client; and
- Assess anti-money laundering and terrorist financing risk.

There does not seem to be a misalignment of client and registrant interests. Furthermore, section 13.2(2) of NI 31-103 is clear and explicit:

> "A registrant must take reasonable steps to
> (a) establish the identity of a client and, if the registrant has cause for concern, make reasonable inquiries as to the reputation of the client,
> (b) establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded,
> (c) ensure that it has sufficient information regarding all of the following to enable it to meet its obligations under section 13.3 [*suitability*] or, if applicable, the suitability requirement imposed by an SRO:
> (i) the client's investment needs and objectives;
> (ii) the client's financial circumstances;
> (iii) the client's risk tolerance, and

(d) establish the creditworthiness of the client if the registered firm is financing the client's acquisition of a security."

The Consultation Paper does not clarify where the realignment of the interests of registrants and investors is needed or how the targeted reforms which are directed towards collecting more KYC information will enhance the outcomes for investors. As in the case of conflicts of interest, the reforms in the Consultation Paper add new requirements and replace a common regulatory requirement with a new and unknown requirement. The result will be increased regulatory burden and confusion for both registrants and investors.

The current KYC requirements are robust and extensive. The Consultation Paper proposes to add new elements to the KYC process which, in our opinion, do not serve the goals articulated by the Consultation Paper and are problematic from a practical perspective as noted below.

The requirement to collect basic tax position information will be difficult to implement and supervise, and will lead to a problematic expectation gap between investors and the registrants. Understanding basic tax position is not that basic. There are accountants, lawyers and other specialists that command a princely sum for their understanding of tax provisions. The fact is the *Income Tax Act* (Canada) is one of the few statutes that exceeds the weight and girth of the various securities acts. It is not realistic to expect all registrants to understand the tax position of their clients, basic or otherwise. In addition, this requirement could lead to a greater expectation gap as investors may think the registrant has some expert knowledge in tax. This could result in investors not seeking independent tax advice and just relying on the registrant.

Registrants are already required to assess an individual's tax position when required based on the nature of the product. Some EMDs offer tax efficient investments (e.g. flow-through, mortgage assignment, registered plan eligible investments) and they collect basic tax information. With these types of investments tax information is integral to determining the suitability of the investment. However, basic tax information is not always required to determine the suitability of a single investment. The PCMA wonders if there is a potential privacy concern if registrants collect tax information when it may not be required to assess suitability. In an industry where there are a wide variety of firms and products, the flexibility of principles-based regulation is beneficial to both registrants and investors.

The CSA is proposing to replace the concept of 'risk tolerance'. This is a customary and usual standard used by investment industry. The concept is ubiquitous in securities regulations around the world, yet the term risk tolerance is not mentioned anywhere in the Consultation Paper. Instead, Appendix B of the Consultation Paper identifies the following practices for registrants to assess risk tolerance:

> "the firm's and representative's approach in ascertaining their clients relationship toward investment risk (the client's "risk profile") should include a thorough exploration of the relevant subjective and objective factors, preferably through the use of charts, graphs and examples. In addition, we would expect that any explanation of risk should include an

> explicit explanation of potential financial losses, not just different levels of volatility, and risk-adjusted returns."[5]

There are six detailed bullets in Appendix B describing the information to be collected and analyzed relating to risk. The section concludes with:

> "Firms and representatives should use professional judgment to combine all of these various factors to determine a client's risk profile. Arriving at this overall determination is the primary objective of the risk profiling exercise and firms should ensure their process is supportable and reliable;"[6]

The CSA appears to be focused on process and academic concepts relating to risk rather than suitable investments. The PCMA suggests the CSA focus on the explanation of potential losses and gains. A registrant having an outstanding process to create a client risk profile will not make investors understand that an investment can make money or lose money. The CSA could consider improving financial literacy and understanding of financial terms among investors as well as provide guidance to registrants on presenting and explaining risk to clients.

Section 13.3 of 31-103CP requires that the registrant have a comprehensive understanding of the client's "risk tolerance for types of securities and investment portfolios, taking into account the client's investment knowledge". 31-103CP also recognizes that a client could have different risk tolerances for different accounts.

The investment industry speaks in terms of risk and reward. Reasonable steps should be taken to ensure the client understands the risk of an investment or strategy and the impact of this risk on the downside as well as the upside. The client must be able to accept the risk based on their risk tolerance, investment knowledge, financial and personal circumstances. This is the current requirement.

Outside of collecting basic tax position information and the new risk profiling process, the guidance in Appendix B in relation to collecting KYC information is consistent with the current practices in the industry.

Finally, requiring the annual updating of KYC forms is impractical in Canada's private capital markets. Exempt market products generally represent only a portion of a client's portfolio. As a result, an EMD may not deal with a client for a period of years, or may only ever make a single transaction with a client. The customary and usual practice for EMDs is to ensure the client's KYC form is updated prior to making a trade. This is consistent with the current guidance in section 13.2 of 31-103CP.

Responses to Questions

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?

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[5] (2016), 39 OSCB 3983

[6] (2016), 39 OSCB 3983

We feel the CSA is asking the wrong question. It should ask "do registrants need the proficiency to understand their client's basic tax position". We do not see how collecting basic tax information for all clients will better align the interests of investors and registrants or generally ensure investments are more suitable. Requiring basic tax knowledge by registrants could lead to a greater expectation gap, as investors would think the registrant has some expert knowledge in tax. Tax matters can be extremely complex and registrants should not be encouraged through regulation to give advice on tax strategies when they do not have that expertise. This could result in investors not seeking independent tax advice and just relying on the registrant.

The collection of tax information may be difficult for a number of reasons. Tax information is highly private and many investors, especially Permitted Clients, would refuse to provide this information. Many investors have tax matters handled by outside professionals and service providers and may not have this information readily available. The collection of this type of information is a burden on investors as well as registrants.

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?

We do not see a great deal of value to mandating a KYC form. The type of information to be collected has been well-established and much guidance has been provided by the CSA. Some registrants in the private capital markets are currently rolling out digital KYC forms. These forms are being customized to provide additional information and auto fill other documents. Mandating a specific form would curtail these advancements. Again the flexibility of principles-based regulation is of value in this area.

If regulators see gaps in KYC information collected, CSA Staff Notices are an appropriate tool for providing guidance. The CSA has not provided, and the PCMA is not aware of, any compelling reason for mandating a standard form.

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

The PCMA recommends the CCO or a member of the registrant's compliance team review and approve ("sign off") the KYC form. In small firms the CCO and dealing representative may the same person. In these instances, it is recommended that another qualified registrant within the firm sign off if feasible. The PCMA supports this industry best practice.

54) To what extent should the KYC obligation require registrants to collect tax information about the client? For example, what role should basic tax strategies have in respect of the suitability analysis conducted by registrants in respect of their clients?

The PCMA recognizes that each individual's tax situation is different and that clients should consult with tax advisers prior to investing. We do not believe that basic tax information should be collected in all cases. Basic tax strategies are important in some unique circumstances, such as in wealth planning and determining the suitability of tax efficient investments. Accordingly, a flexible standard that accounts for the different types of investments, and requires tax

information only in those cases, best addresses the realities of the diversity of investment registrants, financial products, and investment goals.

55) To what extent should a representative be allowed to open a new client account or move forward with a securities transaction if he or she is missing some or all of the client's KYC information? Should there be certain minimum elements of the KYC information that must be provided by the client without which a representative cannot open an account or process a securities transaction?

The answer to this question is highly fact driven and the first part cannot be answered in a general sense. However, there is no case in which a trade should be made where all the KYC information is missing. The minimum amount of KYC information collected should be the amount that allows a registrant to:

- assess whether a client is eligible to make an investment in a particular security;
- assess the suitability of a recommended investment for a client;
- determine the reputation of a client; and
- assess anti-money laundering and terrorist financing risk of the client.

56) Should additional guidance be provided in respect of risk profiles?

The PCMA does not believe that investment risk tolerance, a well-established concept, should be replaced by a detailed and potentially confusing risk profiling process that will be difficult and costly for EMDs to implement. More efforts should be made to educate investors about risk and reward. Guidance on explaining this information to clients would be useful. The PCMA is supportive of government initiatives to include financial literacy in the overall education curriculum across the country.

57) Are there circumstances where it may be appropriate for a representative to collect less detailed KYC information? If so, should there be additional guidance about whether more or less detailed KYC information may need to be collected, depending on the context?

The PCMA believes the current guidance in 31-103CP is adequate:

> "In some cases, the registrant will need extensive KYC information, for example, if the registrant is a portfolio manager with discretionary authority. In other cases, the registrant may need less KYC information, for example, if the registrant only occasionally deals with a client who makes small investments relative to their overall financial position.
>
> If the registrant recommends securities traded under the prospectus exemption for accredited investors in NI 45-106, the registrant should determine whether the client qualifies as an accredited investor based on the detailed KYC information collected.
>
> If a client is opening more than one account, the registrant should indicate whether the client's investment objectives, time horizon and risk tolerance apply to a particular account or to the client's whole portfolio of accounts."

This flexible standard accounts for the diversity of investors and registrants, and appropriately accounts for the various factors at play in the registrant-client relationship.

Know Your Product

General Comments

The CSA has aspirational standards of product shelf investigation, development and optimization and implies that EMDs are not looking after the interests of their clients. The PCMA does not agree that imposing such requirements will best serve the industry let alone clients.

As part of the PCMA's response regarding the targeted KYP reforms, we believe certain KYP matters need to be addressed.

The CSA states securities law has no explicit KYP requirement and assumes there is a problem. The Consultation Paper states the following:

" • Although KYP is a key element of the suitability analysis, it is not an explicit, stand-alone requirement (currently embedded for dealing representatives as an element of proficiency that applies only when a recommendation is made, but not explicitly when the client initiates the order)
- No explicit requirement for representatives to know about all the products on their firm's product list, how each product compares to the others, and all fees, costs and charges connected to the product, the client's account and the product and account investment strategy
- No explicit role for the firm in meeting the KYP requirement
- No explicit requirements for shelf development by the firm"[7]

Section 3.4 of NI 31-103 states:

> "An individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently, including **understanding the structure, features and risks of each security the individual recommends**." [emphasis added].

We respectfully submit this is an explicit requirement and with the exception of the second point, addresses the CSA's areas of concern.

It would appear the CSA has concerns with EMD product shelves; however, it has not explicitly identified its issue or concerns in the Consultation Paper. Instead, the CSA has set out a targeted KYP process without identifying what failures it is attempting to resolve. If the existing KYP process and shelf development process is not working, the PCMA expects the CSA to provide a detailed list of its issues and/or concerns. Such information was not provided so it is difficult to provide a meaningful and detailed response based on incomplete information.

As noted elsewhere, not all registrants or EMDs are the same. The CSA's intended outcome is that EMDs who sell a mix of proprietary and non-proprietary product offerings engage in a

[7] (2016), 39 OSCB 3954

market investigation to provide a broad range of products suitable for their client base. Ideally, this outcome makes sense if in fact all registrants were the same.

The 'one-size fits all' approach may not be a suitable approach for regulating registrants. There are many EMD business models and only some sell proprietary products. Their business is to sell products investors want otherwise they would not be in business. Accordingly, we find it curious that the CSA sees a need to interfere with the dynamics of the marketplace.

An EMD may only want to sell proprietary product or have a limited product shelf for a variety of reasons. For example, a boutique EMD that focuses on mining and has the knowledge, experience and skill to underwrite such offerings may not want to sell other products to their investors despite their client's investment needs. Such EMDs are transaction-based and do not seek to investigate let alone offer other products to their investors. EMDs and dealing representatives should have the freedom of choice to operate their businesses in the manner they see fit.

The targeted KYP reforms also assume that a private capital markets investigation is possible. Unfortunately, there is no 'supermarket' of securities where an EMD can review various product offerings in different industries and then choose which ones they want to sell as part of any market investigation or optimization process. There is no centralized and accessible database where one can search and analyze various private capital market offerings in order to compare one to another let alone engage in shelf development and/or optimization.

Notwithstanding the foregoing, we note the BCSC and OSC requires the filing of certain offering documents on its website portal including the filing of offering memoranda for securities distributed under section 2.9 of NI 45-106 (the offering memorandum exemption). Although such offering documents are available, the BCSC's website search capabilities are unfortunately rudimentary and it only involves the filings in one Province. In addition, we note certain CSA jurisdictions have recently required the filing of certain offering documents on SEDAR in 2016.[8] Although this is helpful, the database of offering documents is still new and small at this time. SEDAR will not have offering documents for securities distributed under other prospectus exemptions such as the Accredited Investor exemption in section 2.3 of NI 45-106.

Our point is that the private capital markets are not like the public capital markets where all information is readily available and searchable on a centralized database such as SEDAR. Accordingly, in the absence of a truly centralized database where information about local and foreign issuers and offerings can be found, it is unclear how the CSA expects an EMD to engage in any market investigation. Until a database or 'supermarket' of private capital market offerings exists, the PCMA submits that EMDs cannot engage in any market investigation, review or optimization process to the extent set out in the targeted KYP reforms.

EMDs continually seek to add or remove offerings from their shelf, but they do not do so by reference to a centralized database of available offerings, as seemingly presumed by the CSA. An EMD's product shelf may be specialized or industry specific (e.g. mining) or broad-based

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[8] See *Multilateral CSA Notice of Amendments to National Instrument 13-101 System for Electronic Data Analysis and Retrieval (SEDAR)* and *Multilateral Instrument 13-102 System Fees for SEDAR and NRD*.

where it sells a variety of investment products. It may be proprietary, non-proprietary or a mix of both. This is reflected in the various EMD business models. Accordingly, there are a number of factors that have an effect on an EMD's business model and shelf development, as discussed below.

Knowledge and Experience – An EMD may not have the requisite knowledge and experience to undertake a broad market investigation in areas that are outside its expertise. Even if an EMD desires to sell products that are most likely to meet the needs of its investors, it should not do so in certain cases where it would fail in its KYP obligations to truly understand a product and provide the requisite training for its dealing representatives due to a lack of expertise.

Cost – The cost to undertake any market investigation can be prohibitive. A review of any product in the private capital market takes considerable time, money and resources. It is not simply a matter of typing search criteria into a centralized and accessible database and easily obtaining a list of private capital market issuers that satisfy one's search query.

For an EMD to undertake a reasonable investigation, it must engage in a due diligence review of an issuer. This typically involves entering into a due diligence or engagement agreement with an issuer that generally requires an issuer to pay a due diligence fee to an EMD. An issuer may not want to pay a fee and accordingly, an EMD may not want engage in any due diligence. Alternatively, even if an EMD is willing to complete the due diligence without charge, an issuer may not want to work with the EMD for any number of reasons, including that the EMD does not have a broad distribution base and is too small. Cost plays an important role in shelf development.

Dealing Representative Demand – An EMD may also add a product to its shelf that is requested by an existing dealing representative or by a dealing representative transferring from another EMD as a prerequisite to moving to the EMD. This demand would also impact product shelf design.

Exclusivity – Certain issuers may have an exclusive arrangement with an EMD to sell its securities and this would also impact an EMD's product shelf since such products would not be available to other EMDs.

Size and Resources to Access Deal Flow – Most EMDs are small based on the number of dealing representatives registered with a particular dealership. Many EMDs cannot afford to hire a professional corporate finance team that actively searches and solicits issuers to raise capital for them. More often than not, an EMD develops a reputation and issuers often seek out an EMD to sell its securities in connection with a private placement offering.

Although this may not be the most efficient way of adding or removing issuers from an EMD's product shelf, it does work. Moreover, EMDs are in the business of selling securities that satisfy investor needs and hence earn a commission. The dynamics of the marketplace will force an EMD to optimize its product shelf to remain viable.

Notwithstanding the foregoing, the PCMA believes the CSA is forcing an unrealistic KYP requirement on all EMDs arising out of its concerns with certain EMDs selling only one proprietary product, a few non-proprietary products or a limited mix of both. The PCMA believes the key outcome is that a trade is suitable. Fulfilling the suitability requirement means satisfying KYP and KYC standards.

We understand the CSA may not want an EMD to sell only one proprietary product, a few non-proprietary products or a limited mix of both, but this is a function of the supply and demand. A niche focus should not be viewed as bad for the industry. Niche products and EMDs should be encouraged and not discouraged. A consumer can shop at a supermarket, a boutique shop or a store that sells only one product. An investor can choose to invest through a dealer that offers a whole suite of products or a boutique dealer that specializes in a particular sector or both. The dynamics of the marketplace will determine whether an EMD can survive and remain viable based on consumer demand.

The PCMA submits the targeted KYP reforms are aspirational and do not reflect the realities of the private capital markets. We further believe the targeted KYP proposals are based on the erroneous assumption that the current KYP processes do not achieve the CSA's goal of investor protection. The PCMA is not aware of any study or findings demonstrating why the CSA should interfere with the market-based product shelf design that we believe presently works.

The PCMA believes a dealing representative must have the requisite knowledge of each product they recommend and sell in order to satisfy their regulatory obligations. However, requiring EMDs to have knowledge of all products on the shelf will undermine the goals of securities regulation, as it will encourage registrants to limit their product shelf to those products they understand. For example, an EMD could have a flow-through investment product on their shelf and a dealing representative may have little knowledge about the product since they do not understand the industry and the tax complexities of the product.

If a dealing representative is required to know a product and lacks the sophistication to sell it, then forcing knowledge of all products will result in an EMD eliminating products. The EMD would have to tailor its shelf to the knowledge level of its least sophisticated dealing representative. This is an unintended consequence does not help issuers or investors since it will limit capital raising to the most basic of financial products. It also adversely impacts more sophisticated dealing representatives who may have the requisite knowledge, designations or otherwise that would allow them to sell a more sophisticated product.

An EMD that only sells its own product should provide investors with disclosure so clients understand the relationship and conflict of interest. For example, it is not hard to understand that State Farm or London Life agents only sell insurance policies for their respective firms. They are not life insurance brokers representing a number of different life insurance companies. The same case can and should be made for EMDs. A registrant should not be forced by the CSA to sell non-proprietary products. That should be a choice of the registrant based on its business model.

The PCMA believes the regulatory requirement and the desired outcome should be that each trade is suitable based on a dealing representative's knowledge of a specific product and his or her client. A registrant that only sells a few products to the exclusion of others should not be seen as a significant deficiency.

Based on the foregoing, the PCMA believes the targeted KYP reforms are idealistic and impractical and will not provide for a fair and efficient capital market let alone provide more and better products for investors.

Responses to Questions

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

This is not optimal; it is an undue interference by the CSA into the dynamics of the marketplace and does not reflect commercial reality. This is clearly a whole new model for KYP and not tweaking or providing a more explicit KYP obligation but a fundamental change of business for EMDs and other registrants. Accordingly, the PCMA believes the status quo should not change and the targeted KYP reform should not be implemented.

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.

The CSA's intended outcome as described ideally makes sense. however, it assumes that a 'one-size fits all' approach is suited for all registrants. There are many EMD business models and some that only sell proprietary products. Their business is to sell products investors want otherwise they would not be in business.

An EMD may only want to sell a proprietary product or have a limited product shelf for a variety of reasons. For example, a boutique EMD that focuses on mining and has the knowledge, experience and skill to underwrite such offerings may not want to sell other products to their investors despite their client's holistic investment needs. Such EMDs are transaction based and do not seek to investigate let alone offer other products to their investors. EMDs and dealing representatives should have the freedom of choice to operate their businesses in the manner they see fit. As mentioned previously, it is not possible to conduct a market investigation of private capital market offerings as envisioned in the proposed targeted reforms.

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?

The CSA has aspirational standards of product shelf investigation, development and optimization and implies that EMDs are not looking after the interests of their clients. The PCMA does not agree that imposing such a requirement will best serve the industry let alone clients for the reasons set out above in our response to Questions 7 and 8.

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

The PCMA believes the current approach is working where market forces dictate supply and demand for product optimization.

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

Below are certain challenges faced by EMDs in response to the CSA's targeted KYP reforms.

Research Report Challenges – The CSA states that an EMD may conduct a meaningful market investigation by using research reports produced by external research report providers. Such providers typically want to be paid and will have the same challenges as an EMD in getting issuers to cooperate in the preparation of such a report since the information is not publicly available. The PCMA submits that the cost of such a report would likely be prohibitive and many EMDs who undertake a due diligence review may not feel comfortable with an analyst's report which is different than a due diligence review. In addition, the CSA compliance teams have expressed their distrust and discomfort with these reports.

Challenges in Determining Client Needs – The CSA assume that an EMD can easily mine its customer database to determine their collective needs and then search for such product. To the extent this is possible, this makes sense, however, EMDs typically do not have sophisticated, easily searchable databases and software to allow them to obtain such information. For example, in the recent OSC Risk Assessment Questionnaire, the OSC wanted to know the percentage of clients over the age of 60.[9] In order to answer this question, some EMDs required internal staff to manually review their books and records to obtain this number. Current systems do not provide such information. Systems typically store client's date of birth not age. In other words, the CSA assumes registrants have software that readily allows gathering specific types of client information which is not realistic.

This is not to say that EMDs do not understand the wants and needs of its clients. Dealing representatives are in the best position to understand their clients' wants and needs since they meet with investors daily. Registrants strive to have a good product shelf that ideally satisfies investor needs. The competitive marketplace incentivizes them to do so.

Issuers May Not Want to be Added to an EMD's Product Shelf – The time, money and resources involved in satisfying an EMD's due diligence review processes may not be worth the costs to an issuer since the EMD may be too small or otherwise and the issuer needs to be selective in committing its resources.

Frequency of KYP shelf review – The time, money and resources to undertake a shelf review is too cost prohibitive for it to be done annually. EMDs are unlikely to keep issuers on their shelf

[9] OSC 2016 risk assessment questionnaire, Questions for Exempt Market Dealers and Restricted Dealers, Question 25 – Investor Client Age

that do not sell based on the laws of supply and demand. Accordingly, forcing a product review on an annual basis or any other frequency is, in our opinion, unnecessary.

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?

The PCMA submits that the targeted KYP reforms will have negative unintended consequences as discussed below.

Viability of EMDs – Many EMDs are small and may not be able to afford the time, money and resources to undertake the CSA's targeted KYP reforms. This may force them out of the business or act as a barrier to entry for new EMDs.

Reduction in Product Shelf – The targeted KYP reforms assume a dealing representative has knowledge of all investment products on an EMD's product shelf and is ready, willing and able to sell them to qualified investors provided that the trades are suitable. Dealing representatives often sell a select number of products to their investors for a variety of *bona fide* business reasons even though a much larger product shelf is available. As a result, dealing representatives will not have knowledge of all investment products on an EMD's shelf. If this aspirational standard becomes the requirement, then EMDs will limit their product shelf. Limiting an EMD's product shelf will have an immediate and direct impact not only on investor choice but also capital raising in Canada which is necessary for a healthy and growing economy.

*Impairment of Capital Raising for Small and Medium Sized Enterprises ("**SMEs**")* – The targeted reforms could lead to further problems for SMEs trying to raise capital in Canada. Fewer EMDs carrying fewer products combined with higher costs associated with raising capital, SMEs will have a difficult time finding an EMD or other registrant to underwrite and sell their securities. This could result in SMEs not starting or expanding their business. This may also lead to SMEs seeking to raise capital outside of Canada and possibly moving business and employment opportunities out of Canada as well.

Certain dealing representatives may have the knowledge, skill and investor base to sell a tax-based product, a yield product or real estate product or only a few products on an issuer's shelf. This is not an abdication of an EMD's and dealing representative's regulatory responsibilities but a decision by a dealing representative to undertake their own KYP of products on their EMD's shelf and sell those that they understand and that are suitable for their qualified investors.

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, if an EMD must commit the time, money and resources to pursue the targeted KYP reforms, then they may stop offering non-proprietary products so they can fit the definition of a proprietary firm. EMDs and all registrants should be encouraged to sell the products that fit their business models and not be stifled. The CSA's targeted KYP reform is directly interfering with

the dynamics of the marketplace by assuming the private capital markets work the same as the public capital markets.

Furthermore, the shelf optimization assumes that with new products, a registrant may sell a client's holdings in favour of 'better product'. Private capital market investments are generally illiquid. Although certain private capital market products are redeemable (e.g. RRSP-eligible products), there are often cash limits imposed by issuers and an investor may not necessarily receive 100% return of capital. The investor will typically receive part cash and the balance payable in a redemption note. Accordingly, if the idea of shelf optimization is to sell existing products and buy 'better' products for private capital market investors, then this is highly unlikely or achievable in the private capital markets. An unintended consequence may be that an EMD and its dealing representatives sell an investor a new product and increase the investor's concentration in private market holdings rather than replace it. We don't believe this is the intended outcome the CSA contemplated and accordingly, the status quo must not change.

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

No, the PCMA believes the CSA should not regulate EMD business models. There is nothing wrong with an EMD selling only proprietary product. There are conflicts of interest but there may be valid business reasons why this is occurring. For example, an operator of a mortgage investment corporation ("**MIC**") may not be able to engage an EMD to sell its securities and, accordingly, becomes registered itself to sell its own proprietary product.

There will always be better or worse competitive products. It is not clear what outcome the CSA seeks to accomplish by having such a MIC investigate its competitors through bench marking or otherwise. The MIC will not stop offering its securities and it should not have to do a head-to-head comparison with a reasonable universe of its competitors and then provide such a comparison to investors. This makes no commercial sense and unduly prejudices the selling of proprietary products.

This is an undue interference by the CSA into the dynamics of the marketplace and does not reflect commercial reality. This is clearly a whole new model for KYP and not tweaking or providing a more explicit KYP obligation but a fundamental change of business for EMDs and other registrants.

As mentioned previously, an EMD that only sells its own product should provide investors with the requisite disclosure so they understand the relationship and conflict of interest.

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?

The PCMA believes investors want to know whether an EMD is a boutique firm, offers proprietary and/or non-proprietary product or a mix of both. They want to know the number and

types of products on an EMD's shelf and how much a dealer has raised for various issuers and any commissions and/or fees payable between them. They want to know about the firm itself.

58) Should we explicitly allow firms that do not have a product list to create a product review procedure instead of a shelf or would it be preferable to require such firms to create a product list?

The PCMA believes there is sufficient information about the KYP processes prepared by various regulators including IIROC. These are often referred to as due diligence procedures. The CSA could publish further guidance in the case of a captive EMD; however, the focus should be on managing the conflicts of interest to ensure investors can make a fully informed investment decision. This may be a more practical way of dealing with conflicts than requiring a captive dealer to show how it compares with its competitors.

59) Would additional guidance with respect to conducting a "fair and unbiased market investigation" be helpful or appreciated? If so, please provide any substantive suggestions you have in this regard.

The PCMA respectfully submits that a "fair and unbiased market investigation" is difficult or impossible to undertake in the private capital markets since such information is generally unavailable or accessible at great costs. This is an important limitation to be seriously considered by the CSA since its notion of a market investigation does not reflect market realities or abilities. The PCMA submits that the laws of supply and demand will provide issuers with the capital they require provided they are desired investments by investors.

60) Would labels other than "proprietary product list" and "mixed/non-proprietary product list" be more effective? If so, please provide suggestions.

These labels are distinctions used by CSA members; they are not customary or usual in the securities industry and are not necessarily meaningful or understandable to investors. Investors care more about the product, management, investment strategy and other matters involving the business and affairs of an issuer and less about whether an EMD sells proprietary or non-proprietary product or both. If the CSA believes investors want to know this then such information can be added to a registrant's relationship disclosure document.

61) Is the expectation that firms complete a market investigation, product comparison or product list optimized in a manner that is "most likely to meet the investment needs and objectives of its clients based on its client profiles" reasonable? If not, please explain your concern.

Issuers seek dealers to assist with raising capital since dealers act as intermediaries. Intermediaries then sell securities to investors, *provided that* they are suitable investments. The targeted KYP reform assumes investors engage dealers to find issuers. This is not the case in the private markets and an expectation of completing a market investigation or product optimization for clients is opposite of the reality in the private capital markets which, again, are transaction-based. EMDs and dealing representatives do not manage a client's portfolio nor can they readily

sell securities as can be done in the public markets. Accordingly, the PCMA believes this targeted KYP reform is a new paradigm that is being forced onto registrants and does not reflect what is in the best interest of investors.

Suitability

General Comments

The existing suitability standard is robust, rigorous and clear. The proposed targeted reforms and new standards create uncertainty, and are ill-suited to account for the diversity of market participants.

The current requirements of section 13.3 of NI 31-103 are:

"(1) A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.

(2) If a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless."

Evidently, the suitability requirement applies to recommendations to buy, sell or hold securities. Suitability as generally understood, includes due diligence of the client (KYC), due diligence of the product (KYP), and professional judgment of the registrant (education, experience, and integrity).

It is impossible for a registrant to meet the obligations in section 13.3 of NI 31-103 without completing the tasks, or acquiring the requisite knowledge, outlined in Part 4 of the Consultation Paper. In other words, there is no need to explicitly require what is already a necessity to meet the current standards.

In relation to the issue of suitability having a trade focus, the PCMA agrees with the CSA approach of including the phrase "investment strategy involving a security" in the suitability requirement.

In Part 7 of the Consultation Paper, the CSA expands upon what it calls the three elements of suitability: basic financial suitability, investment strategy suitability, and product selection suitability. Until the publication of the Consultation Paper these three elements of suitability were previously unknown. These terms are not used or defined in the materials for the EMP Course, the Canadian Securities Course, the CFA course materials or even on the internet. It is impossible to meet a standard for which no independent information exists.

Replacing the suitability standard appears to be an attempt by the CSA to protect investors from their own judgment. As noted by IOSCO in its principles of regulation, "regulation should not be expected to remove risk from the capital markets, but it should ensure proper management of that risk". There are a myriad of reasons for suitable investments to fail but under the new suitability standard the registrant can be held accountable for losses for not having done a proper basic

financial suitability assessment, investment strategy suitability assessment, product selection suitability analysis or not recommending the security most likely to meet the needs of the client.

Basic financial suitability requires registrants to act as financial consultants for investors. Just like other targeted reforms, this requirement could result in further reliance on a registrant in an area where the registrant does not have expertise. This could result in investors not seeking independent financial planning advice and just relying on the registrant. This is also incongruous with the targeted reform for relationship disclosure information where a registrant must disclose services it does not provide, for example, financial consulting.

EMDs do not typically provide asset allocation plans or an investment portfolio strategy. Therefore, the reforms do not appropriately account for the unique role played by EMDs. As a result, the investment strategy suitability places a requirement on a registrant to undertake an activity where they may not have the skills or expertise. The descriptions of many of the activities described in Appendix E are the skills a reasonable investor would expect and rely upon from a portfolio manager or financial planner but not an EMD. Most reasonable investors would not expect an asset allocation plan or investment portfolio to be designed by an EMD. A reasonable investor will likely be confused why the dealing representative is asking all kinds of information which have little bearing on the purchase of securities of, for example, a real estate opportunity.

Product selection suitability almost sounds like the current standard (and customary and usual practice) in place today when recommending a specific security. Where it is completely different is that a registrant must not only know the product on their dealer's shelf but also know another registrant's product, and know any products the client makes inquiries about. In the case of private securities, this is almost impossible due to the scope of potential investments. This will be a bigger issue as reasonable investors in Canada start to emulate the portfolios of the major pension funds in Canada and start to have significant holdings in private securities.

The PCMA does not believe that an EMD, can meet this three element suitability standard. As noted above, to assess suitability you must have KYC, KYP and professional judgment. All registrants will be able to collect KYC information necessary to conduct a suitability analysis. However, registrants may not have the requisite knowledge of all the products on a dealer's approved list, all the products currently held by the client but the dealer does not have on its list, including private securities, and all products the client makes an inquiry about. Similarly, EMDs and other restricted registrants will not have the requisite skills and expertise to create asset allocation plans and determine targeted rates of return.

We agree with the CSA that registrants should not engage in strategies that benefit the registrant at the expense of the client. We also agree with the 'portfolio approach' to suitability analysis in relation to risk tolerance and concentration of investments. For example, a client with a medium risk tolerance may have both low and high risk securities in their investment portfolio to result in an overall medium risk. We do not believe a registrant should have knowledge of all investments and strategies that went into designing the portfolio.

Conducting an annual suitability analysis is impractical in the context of an EMD, as EMDs typically do not hold or have access to client assets or funds. It is the customary and usual practice for EMDs to review KYC information and conduct a suitability analysis at the time of each trade for a client.

Responses to Questions

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

No. The PCMA believes this could require registrants to provide advice in areas where they do not have the required expertise. This may also inadvertently increase reliance on a registrant.

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 PCMA is concerned that 'most likely' can be perceived as a guarantee against investment risk or business failure. As noted previously, IOSCO, in which the CSA is represented, has stated that regulation should not be expected to remove risk from the capital markets. We have concerns that the standard created by the CSA will put the onus of investment failures, or the failure of a particular investment to meet its objectives on registrants.

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

The PCMA supports more guidance in relation to the expectations of regulators particularly in assessing the suitability of prospectus exempt investments. We do not support more regulatory requirements, especially as outlined in the Consultation Paper, as they cannot be met.

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

No, this is the requirement in the current rule.

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?

Firms registered solely as an EMD typically do not hold client assets. In the case of EMDs, they are required to conduct a suitability assessment as the time of recommending a trade. Clients may invest in a security with a long term hold period such as 5 years or more with no ability to

redeem or sell their investment. In these instances, clients would be frustrated if registered representatives asked for yearly updates to the client's KYC information.

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?

The PCMA does not agree with the new suitability standard created by the CSA. It requires skills that a registrant may not possess including creating an asset allocation model and calculating a target rate of return. Targeted rates of return require an understanding of a client's entire portfolio. Private capital market products are typically only a portion of an investor's portfolio, and therefore EMDs cannot properly calculate targeted rates of return. This renders the new suitability standard as proposed unworkable.

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?

In general, a suitability review will result in an outcome to buy or not buy, hold or not hold because the investment is suitable or not suitable. We don't believe this will raise any problems with registrants.

62) What, if any, unintended consequences could result from setting an expectation in the context of the suitability obligation that registrants must identify products both that are suitable and that are the most likely to achieve the investment needs and objectives of the client? If unintended consequences exist, do the benefits of this proposal outweigh such consequences?

The PCMA has concerns that the term 'most likely' can be perceived as a guarantee against investment risk or business failure. Our concern is that this standard will put the onus of investment failures, or the failure of a particular investment to meet its objectives, on registrants.

We are very concerned that one of the unintended consequences of this regulatory change will be the withdrawal of E&O insurance for EMDs and other registered dealers by insurance providers. This could easily result in EMDs and dealing representatives leaving the industry. This change could also result in an increase in client complaints made to OBSI. The PCMA also believes that requiring registrants to have knowledge of other financial strategies, create asset allocation plans and have omniscient product knowledge will further exacerbate the expectation gap. We do not see any salubrious benefits to this proposal.

63) Should we provide further guidance on the suitability requirement in connection with ongoing decisions to hold a position?

The current rule requires a suitability analysis to be conducted on a hold recommendation.

64) Should we provide further guidance on the frequency of the suitability analysis in connection with those registrant business models that may be based on one-time transactions? For example, when should a person or entity in such a relationship no longer be a client of the registrant for purposes of this ongoing obligation to conduct suitability reviews of the client's account?

The suitability requirement should not apply when there is no transaction or no strategy involving a security being considered. Where an EMD does not hold client assets, there should only be a suitability analysis when a transaction takes place. Furthermore, the guidance in companion policy to NI 45-106 notes it is not necessary to monitor that an Accredited Investor continues to meet the qualification of the exemption after the trade is made. For EMDs, meeting an exemption under NI 45-106 is a key component for assessing the suitability of an investment.

Relationship Disclosure

General Comments

The PCMA is supportive of providing clients easy-to-understand disclosure that helps clients understand the implications and consequences of the information being provided. We are supportive of receiving guidance in the form of a principles-based approach that will allow each firm to tailor their disclosure to best describe their business model.

Currently, investors have recourse against issuers in the event an offering document contains a material misstatement. However, such statutory rights are not harmonized across CSA jurisdictions. The PCMA feels these statutory rights should be harmonized and also provided to investors in relation to the relationship disclosure information provided to clients by their dealer or advisor.

Responses to Questions

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

Yes, disclosure about a firm's restricted category of registration in easy-to-understand terms is helpful for clients to understand the limited nature of the investment advice they can receive from the registrant.

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

The PCMA agrees with the concept of disclosing relationship information if the firm offers only proprietary product. It will help clients understand the tied relationship between the EMD and the issuer. This situation is similar to when a client goes to a bank and is offered a product issued

by the bank. The client expects and understands that the bank sells proprietary products and not products issued by a competing bank.

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

The proposed disclosure is workable for EMDs.

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

We feel that this is best answered by the investment dealer and portfolio manager industry groups such as the Investment Industry Association of Canada and the Portfolio Managers Association of Canada.

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

Guidance is always appreciated but we feel this should be in the form of guidance and not be prescriptive. This would allow firms to determine the best way to describe their business model to their clients as not all firms are the same.

Proficiency

General Comments

In 2016, the Exempt Market Product Exam and related materials where updated and revised as part of a collaborative effort between IFSE (the educational arm of The Investment Funds Institute of Canada) and the PCMA.

The PCMA strongly believes that the proficiency requirements have been increased for new exempt market dealing representatives entering the business.

The new EMP Course has 12 Units divided into three main areas:

- Compliance
  - Overview of the Capital Markets
  - Regulatory Framework
  - Compliance for Exempt Market Dealers
  - Dealing with Clients
  - KYC and Suitability
- Legal
  - The Private Placement Process
  - Structures of Issuers
- Industry
  - Real Estate and Mortgage Investments
  - Flow-Through Shares
  - The Mining Industry
  - The Oil and Gas Industry
  - Hedge Funds

The targeted reforms adopted by the CSA would have to be added to the Compliance sections to the extent they are not already explicitly covered.

The purpose of the EMP Course is to provide the fundamentals and basic proficiency requirements for an individual seeking to sell prospectus exempt market products. It is not intended to be an introductory course or primer on mutual funds, fixed income products or otherwise and must be specifically tailored to focus on products that are sold by dealing representatives of exempt market dealers. For example, the prior EMP Course materials had a chapter on Principal Protected Notes ("**PPNs**"). Generally, dealing representatives of exempt market dealers do not sell PPNs; hence, to many, the inclusion of PPNs in the course was irrelevant to the proficiency involved in the sale of exempt products.

If the CSA desires certain outcomes to be achieved in proficiency, we believe that the CSA must become actively involved in curriculum design and cannot abdicate such responsibilities and leave it for the marketplace to develop. To ensure dealing representatives have the requisite proficiency to satisfy their regulatory obligations, we recommend the CSA establish a Registrant Curriculum and Ongoing Proficiency Working Group with input from industry. This would allow the CSA to ensure the course materials match the desired regulatory outcomes, are consistent with the customary and usual industry practices, and that they are periodically reviewed and updated.

The PCMA believes continuing education by dealing representatives should be encouraged and has no objection with the CSA mandating a minimum number of continuing education credits per calendar year. The PCMA believes the CSA's review of proficiency requirements and continuing education should be part of the mandate of the Registrant Curriculum and Ongoing Proficiency Working Committee as described above. We understand the AMF has staff with pedagogical expertise.

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

The PCMA has very significant concerns with the over-reaching approach taken by the CSA in certain targeted reforms that want to train dealing representatives to be well rounded financial planners who have knowledge of all types of securities and basic tax knowledge to provide tax advice on client's investments. The PCMA disagrees with this approach that encroaches on other proficiencies and areas of registration. For example, dealing representatives should not be required to satisfy proficiencies involving scholarship plan securities since this is outside the purview of their registration category. In sum, the PCMA has concerns with what we refer to as '*proficiency creep'* into other areas of registration.

The PCMA reminds the CSA that dealing representatives of exempt market dealers are only involved with private placements of securities under available prospectus exemptions. These are transaction-based trades. Increasing the proficiency requirements in product costs and strategies make sense to the extent that it applies to the private capital market only. Furthermore, if the CSA desires to increase the proficiency requirements to include active versus passive investment strategies that impact client outcomes, we strongly encourage that this be developed in the EMP Course curriculum.

We note that many designation holders are required to take continuing education courses as a condition of maintaining their designation. For example:

- the Financial Services Commission of Ontario requires each Level I and Level II life agent licensed in Ontario (resident and nonresident) to complete 30 hours of continuing education every two years;[10] and
- the Registered Insurance Brokers of Ontario (RIBO), the self-regulatory body for property and casualty insurance brokers in Ontario) requires licensed insurance brokers (RIBO brokers) [other than Principal Brokers or Deputy Principal Brokers] to complete 8 hours of continuing education every year.

The PCMA believes continuing education by dealing representatives should be encouraged and has no objection with the CSA mandating a minimum number of continuing education credits per calendar year. The PCMA believes that the CSA must actively participate in the review of proficiency and continuing education requirements and this should be part of the mandate of the Registrant Curriculum and Ongoing Proficiency Working Committee established by the CSA as noted above.

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

A CCO for an EMD is required to successfully complete certain proficiency requirements including the EMP Course and the Chief Compliance Officer's Qualification Exam or the Partners, Directors and Senior Officers Course. With the exception of the recently updated EMP Course, these courses are largely tailored for CCOs of IIROC dealers.

We respectfully submit that the Registrant Curriculum and Ongoing Proficiency Working Committee, as recommended above, should be involved in the design of a CCO course tailored for a CCO of an EMD. Again, the PCMA strongly believes the CSA must have active involvement, and work with industry participants, in designing the course curriculum for a CCO of an EMD if it expects to realize the desired outcomes.

The CSA has over the last few years required an experience requirement for CCOs of an EMD. We believe this is the wrong approach and we refer to our previous comment letter dated March 5, 2014 and available on the PCMA website at: http://c.ymcdn.com/sites/www.pcmacanada.com/resource/resmgr/Comment_Letters/PCMA_-_CSA_NI_31-103_comment.pdf. We believe a more tailored proficiency for the CCO of an EMD is a better approach than the current generic securities industry experience requirement.

The PCMA is of the view that a securities industry experience requirement does not apply well for a CCO of an EMD; the role can be completely different than being a CCO of an IIROC dealer, portfolio manager or investment dealer. The experience requirement acts as a barrier to entry for new entrants by limiting those who could become dealers. Accordingly, the PCMA strongly recommends that the experience requirement be replaced with a more robust proficiency requirement.

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[10] https://www.fsco.gov.on.ca/en/insurance/lifehealthbulletins/Archives/Pages/lh-02_96.aspx

The PCMA notes that in 2013, we provided a full-day training session for CCOs of EMDs and the response by attendees was overwhelmingly positive. Many CCOs commented that they wished such a course was part of their original training and ongoing curriculum. The PCMA strongly believes a well thought out curriculum design that is robust and practical would be a better way to ensure the CCO of an EMD has the requisite proficiency to be a CCO. We recommend that it replaces the experience requirement which we respectfully submit is a poor proxy of what would make a good CCO of an EMD.

There are no proficiency requirements for being the UDP of an EMD. The UDP is a role that is placed upon the Chief Executive Officer of a company due to their title only. The PCMA has concerns with the UDP satisfying the same requirements as a CCO of an EMD. The CEO may not be involved with the day-to-day affairs of the firm as it relates to its registerable activities. For example, the registrant firm may be an issuer and the CEO may be more involved with the day-to-day affairs in relation to its primary business line or the CEO firm may have additional responsibilities in other affiliates of the registrant firm. Therefore, the proposed proficiency requirements may place an undue burden on the CEO in relation to the performance of his or her duties within the entire group.

The PCMA has no objection to mandating continuing education requirements on the CCO of an EMD. The PCMA does not agree with mandating continuing education requirements on the UDP of an EMD. We agree a UDP should have a good understanding of what a CCO does day-to-day to ensure a culture of compliance.

Titles

General Comments

For EMDs, we understand the CSA proposes three alternatives as it relates to dealing representatives:

1. restricted securities advisor;
2. salesperson; or
3. dealing representative.

The PCMA strongly believes that all three titles are confusing to investors and are meant to satisfy legal regulatory definitions. These titles may provide meaning to regulators and lawyers but not to investors. According to IIROC's publication dated January 8, 2013 titled *Use of Business Titles and Financial Designations*, it stated, among other things, the following:

> "Investors generally also did not find titles based on the individual's registration and/or IIROC approval category (e.g., "**dealing representative**", "registered representative", or "investment representative") meaningful." [Page 6][11] [Emphasis added]

The PCMA notes that IIROC does not regulate business titles, as proposed by the CSA in the targeted reforms, but deferred to each IIROC firm to develop policies and procedures to ensure that any titles are not misleading.

[11] http://www.iiroc.ca/Documents/2014/3254a1ea-88c7-4ebb-b00c-4167f2708b67_en.pdf

The PCMA respectfully submits that the three alternatives suggested above are legal titles that are not meaningful to investors and, in some cases, are demeaning to dealing representatives. A dealing representative does not want to be referred to as a salesman or restricted dealer (the latter sounds like they are in training).

The CSA references 48 business titles used by various registrants as misleading in *Mystery Shopping For Investment*. The PCMA notes that dealing representatives should be allowed to use a variety of business titles so long as they are not misleading. Many industries, regulated and unregulated, use various business titles. The PCMA respectfully submits that the CSA's alternative provides no greater insight or meaning than those used by existing dealing representatives.

The titles should not be misleading. The PCMA understands certain titles should not include the word "expert" or "specialist", such as Private Market Expert or Private Market Specialist absent a bona fide designation.

The PCMA strongly believes regulating titles to satisfy legal regulatory definitions will provide no meaning additional clarification to investors. The PCMA has no objection to adding to a business card a statement identifying the individual's category of registration with a particular EMD along with the individual's business title.

Reponses to Questions

30) Will more strictly regulating titles raise any issues or challenges for registrants or clients?

The PCMA disagrees with regulating titles. The PCMA has no objection to adding the registration category to a business card along the individual's business title.

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?

Business cards or company documents should include the individual's category of registration along with the business title. The business title must not be misleading and explicitly state that the individual is a registered dealing representative of the sponsoring EMD. We believe this strikes the right balance.

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

The PCMA has no objection to additional guidance regarding the use of titles by representatives who are "dually licensed" (or equivalent).

Designations

General Comments

The PCMA submits that the CSA should not regulate the use of designations, rather it should create a requirement for EMDs to review and validate the designations used by their representatives.

This is the current practice of IIROC in its publication titled "*Use of Business Titles and Financial Designations*"[12] and the U.S. Securities Exchange Commission (the "**SEC**") and the North American Securities Administration Association (the "**NASAA**") in the SEC-NASAA Investor Bulletin titled "*Making Sense of Financial Professional Titles"*.[13] We understand that the CSA members are also members of NASAA.

While we agree that the CSA should provide guidance on appropriate designations (as does IIROC, SEC and NASAA), we do not feel it is not appropriate for the CSA to dictate or endorse specific professional designations. Rather, the EMD compliance departments are in the best position to review and approve the designations used by their registrants.

The PCMA is also concerned about the use of designations that have weak curriculum and examination processes, no experience requirements, no ethics component, continuing education requirements, public complaint or disciplinary process and issuance by a non-reputable organization.

Response to Question

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?

The PCMA submits that the CSA should not regulate the use of designations; rather it should create a requirement for EMDs to review and validate the designations used by their representatives.

The PCMA is concerned about the use of designations that have weak curriculum and examination processes, no experience requirements, no ethics component, continuing education requirements, public complaint or disciplinary process and issuance by a non-reputable organization.

Role of UDP and CCO

Response to Question

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

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[12] http://www.iiroc.ca/Documents/2013/9d4cb9be-607c-4597-b0ca-92c60efeb48a_en.pdf

[13] https://www.sec.gov/investor/alerts/ib_making_sense.pdf

The UDP is a role that is placed upon the Chief Executive Officer of a registrant firm due to their title only. In some instances, it may be more appropriate for this role to be filled by another individual within the firm such as the Chief Operating Officer or Chief Investment Officer who may be more involved with the day-to-day affairs of the firm. While we appreciate and expect the need for compliance to have a 'tone from the top' culture, the CEO may not be the appropriate person to meet the requirements that have been outlined.

The CCO should be responsible to ensure adequate policies and procedures are in place to meet regulatory requirements such as the collection of KYC and KYP information and suitability analysis. However, they should not be providing suitability analysis for each client's transaction. This is the responsibility of the dealing representative. It is the customary and usual practice for compliance teams to perform periodic reviews to 'audit' that the firm's policies and procedures are being adhered to and to report to management if trends or material issues are detected.

Statutory Duty When Client Grants Discretionary Authority

General Comments

This proposed targeted reform is not applicable to EMDs. We feel this is best answered by the investment dealer and portfolio manager industry groups such as the Investment Industry Association of Canada and the Portfolio Managers Association of Canada who represent registrants that can have discretionary authority over a client's account.

REGULATORY BEST INTEREST STANDARD

General Comments

The PCMA strongly disagrees with the implementation of a regulatory best interest standard as explained below. Accordingly, we do not specifically address questions 36-43 and 65-68 that deal with best interest standard.

The PCMA believes a statutory best interest standard is not necessary, and may even be counter-productive, to achieving the goals of investor protection and ensuring appropriate standards for registrants in Canada. EMDs are subject to a robust and rigorous securities regulatory regime in Canada, which imposes a duty of fairness, honesty and good faith, extensive suitability, KYC and KYP obligations, disclosure obligations around the registrant-client relationship, and conflict of interest standards. Similarly high and flexible standards are also imposed upon EMDs and other registrants by the courts.

The proposed best interest regulatory standard would create legal uncertainty in a securities regulatory environment that already applies appropriate contextual investor protection standards and duties. Moreover, the standard is ill-suited to account for the unique role played by EMDs. EMDs occupy a unique and important position in Canadian capital markets, as they interact exclusively with prospectus exempt securities and investors. Even if the best interest standard is implemented in the broader securities regulatory landscape, we believe it must be appropriately calibrated to account for the special circumstances applying to EMDs.

Current Securities Regulatory System is Robust

Canada's current securities regulatory system is layered, robust and detailed. The provincial securities legislation, in combination with NI 31-103 and 31-103CP, impose stringent requirements aimed at protecting investors while ensuring the efficient functioning of Canada's capital markets.

These obligations include:

- the duty of fairness, honesty, and good faith;
- the suitability assessment process, know-your-client and know-your-product information requirements;
- disclosure obligations and related requirements around the registrant-client relationship; and
- conflict of interest prohibitions and disclosure obligations.

Each of these obligations is addressed below. These obligations are further supplemented by the common law legal standards, which include the imposition of fiduciary duties and are defined and imposed on a contextual, case-by-case basis.

Duty of Fairness, Honesty, and Good Faith

For some time, registered representatives and dealers in Canada have had an obligation to deal fairly, honestly and in good faith with their clients. This obligation is imposed by the applicable legislation in all Canadian provinces and territories.[14]

KYC, KYP and Suitability

The KYC, KYP and suitability obligations are among the most fundamental obligations owed by registrants to their clients and are cornerstones of the investor protection regime. These obligations work together, and are an extension of the statutory duty to deal fairly. The suitability obligation requires a registrant to know their client and know the product that is the subject of the proposed recommendation or client order, and then form an opinion as to whether the product is suitable in light of the client's investment needs, risk tolerance, time horizon and objectives.

[14] See section 2.1 of OSC Rule 31-505, Conditions of Registration; section 14 of the *Securities Rules,* B.C. Reg. 194/97 [B.C. Regulations] under the *Securities Act (British Columbia),* R.S.B.C. 1996, c. 418 [B.C. Act]; section 75.2 of the *Securities Act (Alberta),* R.S.A. 2000, c.S-4 [Alberta Act]; section 33.1 of the *Securities Act (Saskatchewan),* S.S. 1988-89, c. S-42.2 [Saskatchewan Act]; subsection 154.2(3) of the *Securities Act (Manitoba),* C.C.S.M. c. S50 [Manitoba Act]; section 160 of the *Securities Act (Quebec)* R.S.Q., c. V-1.1 [Quebec Act]; section 39A of the *Securities Act (Nova Scotia),* R.S.N.S. 1989, C. 418 [N.S. Act]; subsection 54(1) of the *Securities Act (New Brunswick),* S.N.B. 2004, c. S-5.5 [N.B. Act]; section 90 of the *Securities Act (Prince Edward Island),* R.S.P.E.I. 1988, c. S-3.1 [P.E.I. Act]; subsection 26.2(1) of the *Securities Act (Newfoundland and Labrador),* R.S.N.L. 1990, c. S-13 [Newfoundland Act]; section 90 of the *Securities Act (Nunavut),* S.Nu. 2008, c. 12 [Nunavut Act]; section 90 of the *Securities Act (Northwest Territories),* S.N.W.T. 2008, c. 10 [N.W.T. Act]; and section 90 of the *Securities Act (Yukon),* S.Y. 2007, c. 16 [Yukon Act].

KYC obligations – The KYC requirement requires, in part, for a registrant to take reasonable steps to ensure sufficient information regarding a client's needs and objectives, time horizon, financial circumstances and risk tolerance in order to meet suitability requirements.

Section 13.2 of 31-103CP explains this obligation as follows:

> "Registrants act as gate keepers of the integrity of the capital markets. They should not, by act or omission, facilitate conduct that brings the market into disrepute. As part of their gate keeper role, registrants are required to establish the identity of and conduct due diligence of clients under the KYC obligation in s. 13.2. Complying with the KYC obligation can help ensure that trades are completed in accordance with securities laws."

KYP Obligations – Section 3.4 of 31-103CP explains that registrants must understand the structure, features and risks of each product they recommend as part of their initial and ongoing proficiency obligations. An individual "must not perform an activity that requires registration unless the individual has the education, training and experience… including understanding the structure, feature and risks of each security the individual recommends."

Suitability Obligations – The suitability requirement obligates registrants to take reasonable steps to ensure that before it makes a recommendation to or accepts instruction from a client to buy or sell a security the purchase or sale is suitable for the client, and if is not suitable, to not make the trade and so inform the client.

The amount of KYC information required to meet the suitability obligation depends on the circumstances. The extent of KYC information a registrant needs to execute a trade will depend on the client's circumstances, the type of security, the client's relationship to the registrant and the registrant's business model. For example, a portfolio manager with discretionary authority will need extensive KYC information. However, if a registrant only deals occasionally with a client and this client makes small investments relative to their overall financial position, the registrant's KYC obligations are less onerous.

Disclosure Obligations

Registrant disclosure obligations ensure that clients have the necessary information to understand the services being received from a registrant, the investments under consideration, and the avenues available to address issues with the registrant.

Conflicts of Interest

Registrants are obligated to avoid conflicts of interest and to avoid conflicts through the disclosure of any conflicts to clients. Section 32.1(g) of the *Ontario Securities Act* requires all persons and companies registered under the *Act* to comply with regulations relating to conflicts of interest.

NI 31-103 stipulates that a conflict of interest is any circumstance where the interests of different parties, such as the interests of a client and those of the registrant, are inconsistent or divergent. Registrants must take reasonable steps to identify existing material conflicts of interest and potential material conflicts that the firm reasonably expects to arise between the firm and a client.

Registrants are required to provide timely written disclosure of a conflict of interest where a reasonable client would expect to be informed of the conflict when entering into a proposed transaction. 31-103CP provides extensive guidance on the application of the principals governing the conflicts of interest requirement.

Fiduciary and Duty of Care Obligations Under the Common Law

The spectrum of legal duties imposed upon registrants by the courts is appropriately calibrated based on the circumstances or each advisor-client relationship. At one end of this spectrum is a fiduciary duty, and at the other end is a less onerous duty to take trading instructions and put them into effect. The nature of the duty that exists under common law is informed by the regulatory requirements, such that this spectrum mirrors the KYC, KYP and suitability regulatory obligations described above. As noted, these regulatory requirements are carefully calibrated and adapted to the circumstances of each case – regulators will impose a stricter standard where warranted by the circumstances. Similarly, courts will impose a strict fiduciary obligation where warranted.

"Fiduciary duty" is a common law concept that imposes a duty of loyalty on a person who has been entrusted to look after the best interests of someone else. The scope of this duty has developed and been refined through hundreds of years of common law jurisprudence. It typically arises in circumstances where one individual is particularly vulnerable to the other because of the personal nature of the relationship, or because of the broad scope of authority held by one of the individuals.

There is no legal uncertainty as to whether investment advisors can have a fiduciary duty in some circumstances. A fiduciary duty is found to exist where there is an exercise of discretion or where the underlying facts to the investment advisor/client relationship meet the clearly enunciated legal requirements which include the extent of vulnerability and reliance by the retail investor. The common law has recognized for several decades that the duties an investment advisor owes to his or her client is inversely proportional to the experience or sophistication of that client. Thus, in the same situations where the regulator imposes a strict KYC, KYP and suitability standard, courts will impose a fiduciary duty.

The existing obligations are onerous, are well-known by registrants (including EMDs) and have acted as an effective tool to ensure that registrant conduct is consistent with acting in the best interests of clients.

The Unique Case of Exempt Market Dealers

Exempt Market Dealers act in two principal capacities in the Canadian capital markets:

1. as a dealer for any securities which are prospectus qualified, or prospectus exempt, when they are sold to individuals who qualify for the purchase of exempt securities; and
2. as a dealer or underwriter for securities which are prospectus exempt.

NI 45-106 sets out the qualification criteria for exempt purchasers and securities. Disclosure and prospectus obligations are designed to provide the level of information that investors require to make an informed investment decision. The exempt market exists because Canadian security regulators have determined that certain types of investors require less information, because of

their sophistication, relationship with the issuer, wealth or income. Additionally, securities may be considered exempt because they are subject to other regulatory schemes, or are exceptionally simple to understand and low risk.

EMDs are subject to those stringent regulatory requirements imposed by NI 31-103 that are appropriate to their specific context. EMDs are required to meet substantial dealer obligations, including educational proficiency, capital and solvency rules, insurance, audited financial statements, KYC and KYP obligations, suitability rules, compliance systems, and disclosure of conflicts of interest. The EMD registrant category exists in all provinces and territories in Canada.

However, EMDs are inherently different from other registrants. An EMD will often have a transactional relationship, as opposed to an ongoing relationship, with a client. A transactional relationship is where the EMD's relationship with the client is limited to a specific private placement transaction. In this case, neither the EMD, nor a related issuer of the EMD, holds client assets or securities and the EMD is not paid compensation in relation to the client's ownership of a security. There is no expectation by the client that the EMD will continue to provide services after the completion of the transaction.

Accordingly, the relevant securities law authorities have recognized that securities regulations must be tailored in order to accommodate the unique position occupied by EMDs. CSA Staff Notice 31-345 *Cost Disclosure, Performance Reporting and Client Statements – Frequently Asked Questions and Additional Guidance* outlines the ways in which Amendments to NI-31-103 implementing phase 2 of the Client Relationship Model apply differently to EMDs. For example, where EMDs have a transactional (as opposed to ongoing) client relationship, they are not obligated to provide additional account statements, cost information, reports on charges, or annual investment reports pursuant to ss. 14.14-14.18 of NI 31-103.

The Proposed "Best Interest" Standard

The proposed framework for a regulatory best interest standard in the Consultation Paper, unequivocally supported by only two of the provincial securities regulators, would require that a registered dealer or adviser (and its representatives) deal fairly, honestly and in good faith with its clients and act in its clients' best interests. As registrants already have the obligation to deal fairly, honestly and in good faith with its clients, the proposed regulations effectively propose to implement a new "best interest" standard.

This is a "regulatory conduct standard", and is not intended to be a codification of the common law fiduciary duty. However, the exact scope of this standard is unclear. The extent to which any obligations imposed by this standard would differ from the broad array of duties that already exist is also unclear.

The Ontario and New Brunswick regulators believe the regulatory best interest standard as a governing principle would assist in interpreting the more specific requirements and guide registrants in addressing situations not covered by a specific rule. However, the Alberta, Quebec, Manitoba and Nova Scotia regulators have "strong reservations" about the alleged benefits of this proposal. The British Columbia Securities Commission does not support the introduction of

this standard, believing it will create uncertainty for both clients and registrants, and may be unworkable.

Concerns with the Proposed Best Interest Standard

The B.C., Quebec, Alberta, Manitoba and Nova Scotia securities commissions have expressed concerns about the best interest standard. These general concerns are shared by EMDs:

- The proposed best interest standard may create legal uncertainty. It does not create a clear standard for registrants to follow or for regulators to enforce.
- The proposed best interest standard may exacerbate the expectations gap between clients and registrants because of the existing restricted registration categories and proprietary business models permitted in Canada. Clients may expect that all registrants have an unqualified duty to act in their best interests, not understanding that some conflicts would still be permitted.
- The effect of the CRM2 and Point of Sale initiatives has yet to be analyzed. These initiatives are intended to improve communication in the client-registrant relationship around costs and investment performance. Their effectiveness should be measured before we consider a best interest standard.
- The proposed standard may impact interpretation of existing fiduciary standards for certain registrants such as portfolio managers and investment fund managers.

Beyond these general concerns, the application of the proposed best interest standard is uniquely problematic in the context of EMDs:

- As noted above, EMDs are often engaged in transactional client relationships. Indeed, the CSA has already recognized that securities law principles implemented by CRM2 must be calibrated to appropriately account for this form of relationship. Any regulatory best interest standard should be similarly calibrated to appropriately account for the lack of an ongoing relationship between EMDs and their clients.
- EMDs are solely engaged with securities and individuals who qualify for a prospectus exemption, and therefore the same concerns about investor protection do not apply. The entire exempt market system is based on the principle that investors operating within the exempt market require less information and protection. This is because the investors themselves are uniquely sophisticated, as determined by their wealth and experience investing, or have a unique relationship with the issuer. The securities themselves may be exempt due to the fact that they are subject to increased regulations, or are inherently low-risk.
- The legal uncertainty created by the "best interest standard" would have a particularly devastating effect on the important and valuable role played by EMDs in the Canadian capital markets. EMDs assist small and medium businesses, entrepreneurs and investment funds access capital in situations where they are unable to access the services of a traditional full service dealer. The ability of start-ups and small and medium enterprises to raise capital will be impeded by the regulatory and legal uncertainty surrounded by the proposed standard, hindering entrepreneurship in Canada.

Accordingly, it is not appropriate to apply any proposed "best interest standard" to EMDs. At minimum, the standard must be calibrated to account for the unique position occupied by EMDs

in the Canadian market, and the distinctive nature of the relationship between EMDs and their clients.

CLOSING REMARKS

The preceding remarks express the PCMA's comments on the Consultation Paper. We urge the CSA to take our concerns to heart, as we are concerned that many of the proposals would have serious negative consequences not only for EMDs but also for investors and issuers.

The work that the CSA has done to date to ensure a client-registrant relationship is fair, honest and based in good faith sets a standard that Canada can be proud of for its securities regulatory system. The PCMA would ask that the CSA move forward with prudence along a principles-based regulatory track taking into account the broad diversity of registrants and the unique and valuable role that EMDs play in the Canadian marketplace.

* * * *

We thank you for considering our submissions and we would be pleased to respond to any questions or meet with you to discuss our comments.

Yours truly,

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