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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

Delivered to:

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Dear Sirs/Mesdames:

Re: CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards Their Clients* – published for comment April 28, 2016 Comments from Borden Ladner Gervais LLP

We are pleased to provide the various members of the Canadian Securities Administrators (CSA) with comments on the above-noted Consultation Paper. Our comments are those of individual lawyers in the Investment Management and Securities Litigation practice groups of Borden Ladner Gervais LLP and do not necessarily represent the views of BLG, other BLG lawyers or our clients.

We are motivated to comment on the Consultation Paper, as we were to comment on the earlier Consultation Paper 33-403 (published for comment in late 2012)[1], given our role as trusted legal advisers to many registered firms and individuals, ranging from MFDA and IIROC-member dealer

[1] Our comment letter dated February 22, 2013 is available at this link http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20130222_33-403_cowderryr_gerhartm_dipaolod.pdf

firms and representatives, to portfolio managers (advisers), scholarship plan dealers, investment fund managers and exempt market dealers. In our role as securities lawyers and litigators, we see the interactions of the firms and representatives with their clients and with the various regulatory bodies, we work with many firms to enhance and strengthen their compliance systems and client disclosures and to help them navigate the various regulations that apply to them. We have close interactions with regulatory bodies in reaching outcomes for our clients and the investors they service, with due regard to investor protection concerns. Our work with our clients has given us an informed view of the nature of the financial services industry in Canada today, as well as an unparalleled expertise in registrant regulation and compliance that applies across multiple firms, multiple registration categories and multiple regulators. We are privileged to work with our clients and provide them with legal advice that allows them to comply with both the letter and the *spirit* of the regulations and to keep their clients' interests at the forefront of all they do.

In our February 2013 letter to the CSA we commented that we considered the current regulatory regime worked well in achieving the right balance of investor protection against the regulatory burdens that the regime imposes. We pointed out the various cornerstones of investor protection and encouraged the CSA to "continue to monitor and review the investor protection elements of the current regulatory regime and address any areas that need augmenting or enhancement". We concluded that this would be a more effective route to filling any real investor protection gaps that may exist than what we viewed as an "undefined statutory fiduciary duty, particularly in the case of dealers".

Our comments that follow are not so much that we disagree with underlying regulatory *principles* or even the concept of the CSA "targeting" reforms in certain discrete areas where they prove necessary, but rather that we disagree with some of the enhancements suggested by the CSA (as we will articulate below) particularly as we consider that they will result in a "one-size fits all" regulatory regime that does not recognize – or even may no longer permit - the very different business models and client relationships that exist amongst securities registrants and their clients. Indeed some of the enhancements, in our view, result in the applicable regulatory cornerstone and principle being so ultra "supersized" as to have very little hope of practical and reasonable implementation in some (or all existing) business models, which could result in much more drastic changes to the industry than that anticipated by the regulators. This may have the perverse result of reducing the options available to Canadian investors.

We also fear that the blurring of the lines amongst registration categories that already exists today will become even more pronounced if the targeted reforms come into force. The client relationships of dealers with their clients is much different from the relationships of advisers with their clients – and we believe that the "one-size fits all" approach suggested in the Consultation Paper does not properly account for these differences.

We were pleased to see the drawing back by the CSA from the concept of a "statutory best interest duty" that was articulated in the 2012 paper, in favour of a recognition that it may be appropriate for the securities legislative regime to invariably impose and recognize a "fiduciary" duty only when registrants are exercising discretionary authority granted on them by clients, as may be the case at common law at any event. We have continuing concerns about the so-called "regulatory" best interest standard now proposed with this most recent Consultation Paper, which we articulate below.

As the CSA review our comments, we would very much like to ask the CSA to keep in mind our central submissions, being~~,~~ that we agree with:

- the concept that all securities registrants (firms and individuals alike) should conduct themselves in a professional and proficient manner acting with integrity towards their clients and that any conflicts of interest between the firm, the representative and the client should avoided or resolved in favour of the client to the greatest extent possible and that conflicts should be simply disclosed to the client so that informed decisions can be made

- plain and concise written explanations of material information being provided to clients to allow for informed investment decisions

- firms and representatives being provided (by the applicable regulatory regime and the internal compliance systems) with clear, consistent and commercially viable guideposts to follow to ensure that they understand what they must do to achieve the reasonable investor and proportionate protection goals of the CSA

- securities regulators enforcing the regulatory regime in a fair and balanced manner against any firm and representative who fails to follow the regulatory expectations that clearly apply to them

- the very significant and pivotal role of the SROs (the MFDA and IIROC) setting rules and expectations for the business and financial affairs of their members – and to ensure that there is appropriate investor protection of clients of their members. In our experience, the MFDA and IIROC perform their duties as vigilant and informed regulators in every sense. We recognize that there is a role for the CSA in setting guideposts for that regulation, as they have with NI 31-103, but that detailed regulation and the administration of that regulation should be carried out by the SROs, whose rules, policies, procedures and enforcement activity have a real role in this discussion.

All of our comments should be considered through the lens of our strong appreciation of the role of the securities regulators and the challenges they face in achieving balanced investor protection while fostering, supporting and growing our Canadian capital markets.

We also appreciate that the CSA will continue in its efforts to appreciate, understand and balance the various goals and interests addressed in the Consultation Paper, including through the various Roundtables scheduled for later this year (in December).

The Articulation of the "Problems" by the CSA

1. While we recognize that the CSA must review any existing regulatory regime from time to time to ensure that it continues to achieve the objectives behind such regulation or to ensure that the regime continues to address particular policy concerns that may have arisen anew about the financial services industry, we are troubled by the short discussion and the lack of any real substantiation in the Consultation Paper as to the "key investor protection concerns" which are listed in five bullet points on less than one page. These concerns are cited as the very rationale for drastic changes which would arise from the multiple targeted

reforms and in particular, the proposed regulatory best interest standard. We can only assume that somehow the CSA has concluded that the existing regulatory regime does not deal adequately with these key concerns, but remain unclear as to a solid and consistent basis for this conclusion.

In our view, the concerns are listed as absolutes and as “givens”, without really any explanations of evidence or substantiation. For example, the CSA explains that “clients are not getting outcomes that the regulatory regime is designed to give them”. This statement is simply stated, but nothing is explained as to what this means (i.e. which “outcomes” and indeed what *are* “outcomes” and what is the regulatory regime [as opposed to the capital markets] actually designed to do?), and when coupled with the first concern enunciated as “clients are not getting the value or returns they could reasonably expect from investing” (which we find a very subjective, unexplained and loaded statement), leads us to question the extent of support for these sweeping statements.

2. We also are surprised about the extent of the targeted reforms and the fact that there is no attempt by the CSA to tie the targeted reforms back to cited problems with an explanation as to how the targeted reforms will “solve” the above-noted problems. We have read many of the papers cited by the CSA in the few pages of the Consultation Paper that are focused on the CSA and third party research and feel this research does not fully support or explain these bold statements. These statements are also at odds with our personal and professional experience, as investors and as lawyers to the financial services industry.

   Overall, we consider that the CSA’s explanations as to the findings of the research to be overly categorical and very simplified, whereas the actual findings provided in the research were much more nuanced and less definitive – and in some cases do not actually support the bold statements made by the CSA. It is not the purpose of this submission to provide a detailed review of each academic paper cited by the CSA. However, we provide the following brief examples, which we found noteworthy:

   (a) We agree with the conclusion of the OSC, IIROC and the MFDA provided in the paper entitled *Mystery Shopping for Investment Advice* released in September 2015, that the fact that ‘mystery shoppers’ were not expected to open an account, buy an investment product or commit to any investment strategy were constraints that affected results. These are, in fact, insurmountable constraints, as the ‘mystery shopping’ was based solely and completely on one introductory meeting and therefore unreflective of the realities that advisors may meet and speak with clients multiple times before an account is opened and in any event, certainly throughout the course of the period that the account is opened. It ignores the reality that the Know Your Client and suitability process is ongoing throughout the currency of a longer client relationship.

   (b) With respect to *Current Practices for Risk Profiling in Canada and Review of Global Best Practices* prepared for the Investor Advisory Panel of the OSC, we found the following issues raised by the authors to be significant – and ones that the CSA do not attempt to resolve, address or even mention in the Consultation Paper.

Definitional Problem

For advisors and dealers to meet their regulatory and legal obligations they need a clear definition of client risk. There is inconsistency in language and meaning of risk within regulations and regulatory guidance, and amongst regulators. Regulations that were reviewed for this paper were inconsistent, even a single regulation contained different vocabulary, without definition, referring to 'risk tolerance', 'risk profile', 'risk capacity' and 'risk need'. This may lead to confusion. In reference to 'client risk', do regulators intend to mean the willingness to assume risk, risk capacity or is it intended to encompass all components of a client's risk profile? ….

Proportionality

The regulatory obligations of advisors and dealers mandate the completion of several form, which is both time consuming and cumbersome. In respect of the mandated forms, regulations in Canada do not seem to distinguish between a smaller account that might hold a single mutual fund and a larger account that holds several different securities, or an account that holds only a small portion of a client's investments and one that holds only a small portion of a client's investments and one that holds the entirety of a client's investments. Regardless of size or proportion, the same number of forms and the same process must be followed. Dealers and advisors may not be able to afford the resources required to meet their regulatory obligations if the account size is small. The introduction of minimum investment thresholds or account sizes will not benefit the investment public who don't meet these business thresholds.

(c) We point out the following conclusion contained in the paper entitled *Retail Financial Advice: Does One Size Fit All?* prepared on behalf of the Fama-Miller Center for Research in Finance

Our main finding – that advisor's own asset allocation is the strongest predictor of the allocation chosen on clients' behalf has ambiguous welfare implications. On the one hand, it is reassuring that advisors are willing to hold similar portfolios as they recommend to clients. By doing so, they align themselves with their clients as optimal contracting in principal agent arrangement often prescribes. On the other hand, an advisor may choose a portfolio that is good for himself but that is unsuitable for the clients' preferences and stage of the lifecycle. Moreover, advisors pay lower fees than their clients, so their interests are not completely aligned even when they invest in the same funds…,

The aforementioned paragraph is a reflection of some imperfect premises or tendencies in the Consultation Paper, namely to:

(i) discount the alignments in interests that do exist between clients and the advisors who are motivated to serve those clients honestly and well

(ii) ignore the supervisory regime in place to ensure the suitability of investments

(iii) focus on fees and advisor compensation.

The reality is that advisors, like all professionals, are compensated for their advice, through fees which mathematically impact the net return to clients. A reasonable position could also be put forward to state that this is not a problem as much as it is an unavoidable necessity not exclusive to the financial services industry.

3. We also consider that the "problems" are articulated by the CSA as being universal "problems", which apply to all categories of registrant, all business models, all client relationships and indeed all types of investors. Not only the "problems", but the "targeted reforms" are articulated as "one size fits all" – and we consider this to be a significant flaw in the Consultation Paper.

A much more nuanced approach is necessary and we urge the CSA to re-consider the articulation of the problems as they may arise for the different categories of registrants and client relationships.

(a) One rather obvious example: do these problems really exist when an EMD registrant is dealing with a sophisticated institutional investor that would give rise to the need for the application of the targeted reforms to that registrant and its clients? We consider this should not be the case.

(b) A second example: do these problems really exist with a registered adviser (portfolio manager), with the enhanced proficiency applicable to the individuals who manage other people's money, who is managing money and assets on a discretionary basis in a managed account, even where the client is not an institutional client and may be an individual who is not extremely wealthy or particularly sophisticated? In these circumstances, as the portfolio manager is a fiduciary, do all these problems still apply such that this registrant would be required to comply with all aspects of the enhanced KYP, KYC and suitability requirements? In these circumstances, is the investor's trust in the adviser really misplaced or misguided (one of the stated investor protection concerns)? *Shouldn't* they trust their adviser, given their proficiencies with managing money and the fiduciary obligation of the adviser which is inherent in the relationship?

(c) A third example: do these problems really exist with a scholarship plan dealer who is distributing only very limited types of RESPs (all managed by a related or the same entity) to parents who are interested in saving for their children's education, but who may not have large sums to invest, through RESPs that are offered by way of prospectus and are closely monitored and regulated by the CSA? Is it appropriate for these dealers to tell these parents that they should not save for their children's education, but rather should put their money in a savings account or pay down their mortgage, which might be the result if the CSA's KYC enhancements are adopted? Do these dealers really have to know their client's tax position or socially conscious or religious constraints? If so, what will they be expected to do with this information?

(d) A fourth example: do these problems really exist for dealers and advisers who operate an online advisory model or a discount brokerage on line model? How can these dealers and advisers even begin to comply with the targeted reforms – and why do these problems exist for these services and business models and indeed for the investors who choose to use them?

4. We urge the CSA to also clearly articulate what their real concerns are that underlie the cited research. If the CSA is primarily concerned with dealers and representatives offering an "advisory" service to clients where recommendations are made to clients and clients agree or not with those recommendations so as to invest or not to invest, then we believe the CSA should continue to consult IIROC and MFDA members in the areas articulated in the paper (as necessary), and develop more nuanced requirements, if necessary, as they may apply to different categories of registrants and indeed for the various business models that exist today for IIROC and MFDA firms. The research cited in the Consultation Paper, is primarily, if not all, about the "advisory" model of client relationships inherent with dealers and their clients (who do not manage accounts on a discretionary basis). It is dangerous (we believe) for securities regulators to extrapolate the findings of research to business models and client relationships that are very different from those that were the subject of the research.

In our view, the proposals seem to be aimed at addressing perceived issues that arise when registrants and their representatives are compensated for recommending investments, and in particular investments that are managed "products", rather than for providing portfolio management services. Yet most of the enhanced targeted reforms apply to all registrants and therefore blur the meaning of the various registration categories that the CSA has created and endorsed.

5. We also disagree with the CSA's assertion that investor complaints show a consistent and ongoing non-compliance with current key regulatory requirements and in particular suitability. The reality is that the number of investor complaints relative to the number of investors is marginal. Any investor who complains that (s)he lost money is considered to have made a 'suitability' complaint by the applicable SRO enforcement staff. These investor complaints often confuse 'suitability' with 'performance'. The former involves many subjective factors subject to professional judgment, differing opinions and issues of credibility as between the client and the advisor. The latter is neither a right nor a guarantee.

6. We note that Section 4 of the Consultation Paper entitled *Absence of Certain Explicit Obligations in NI 31-103* ignores the IIROC and MFDA rules, policies, guidances and enforcement decisions in respect of conflicts of interest, know your client, suitability and relationship disclosure which specifically address items listed in that section.

7. The word "product" and "products" are used throughout the Consultation Paper, as opposed to the more usual terms "securities", "issuer", "reporting issuer", "mutual fund" and "investment fund" (which has been the terminology used by securities regulators virtually

since the beginning of securities regulation). Along with other terms that are highly subjective and vague (we point out the most significant examples in our comments) we wonder what the CSA means with these terms? Securities of public companies are not "products" in the sense that mutual funds may be, where a fund manager has created an investment vehicle, set an investment objective and manages the vehicle in accordance with the objectives and strategies. We urge the CSA to narrow down the concerns they have – if they are concerned about manufactured "products" such as investment funds, particularly when the managers of those fund pay dealers compensation for distributing their funds, then they should say this. The word "product" is not generally considered to be synonymous with stocks and bonds of corporate issuers. This is an important concept throughout the Consultation Paper – but particularly around the 'KYP' discussion, where firms are expected to survey the universe of available "products" – the enormity of this task when there are thousands upon thousands of different issuers with securities available to Canadian investors simply cannot be underestimated.

8. We consider that much of the Consultation Paper appears to have been written with the smallest, most vulnerable and least sophisticated investor in mind and with the assumption that the vast majority of investors are financially illiterate, and incapable of understanding that they cannot achieve market returns without market risk. We believe this assumption, in part, has led to the targeted reforms, which are designed to "protect" these most vulnerable investors. We consider that this is problematic in that many of the suggested targeted reforms and best practices will no doubt result in increased regulatory burden, administration, disclosure, costs and business and regulatory risk. This will either result in increased costs for those very same small and vulnerable investors or in registrants segmenting their clients to focus only on the most profitable investors and dropping the clients who do not have sufficient assets to cover these increased burdens. We urge the CSA to consider the potential for these unintended consequences and to consider carefully the submissions of industry participants to this effect.

9. We have not commented upon developments (or the lack thereof) in other countries and encourage the CSA to approach the issues from a uniquely Canadian perspective.

10. Finally, we urge the CSA to consider how the targeted reforms fit with the other regulatory initiatives that are in the process of being completely implemented, including delivery of Fund Facts at point of sale of investment funds (or after a trade in the case of ETFs), CRM2 and the concept of banning embedded compensation paid by investment funds, which are then paid by fund managers to other registrants. Any targeted reforms must recognize, reflect and be proportional to these other regulatory developments and, in our view, should only be proceeded with once the outcomes of those multiple other initiatives (that is, their impact on investors) are properly understood.

Request by the CSA on how to Respond to the Consultation Paper

11. The CSA has asked for responses to 68 questions in the Consultation Paper. We have not chosen to respond individually to these questions, given that many of them are very technical (or theoretical) and some ask for data and input that is best provided by industry participants. CSA staff has publicly urged industry participants to respond to the

Consultation Paper in a constructive manner and provide viable alternatives to the proposals suggested in the Consultation Paper. We hope that our comments are considered to be constructive and helpful –we are not commenting on matters that are beyond our knowledge or experience nor are we advocating on behalf of any of our clients for any particular business model or relationship. Our comments come from our experiences as lawyers and investors and are coloured by our knowledge about what the vast majority of firms and representatives do to achieve the objectives long established by the CSA and the SROs and their desire to be compliant and provide professional advisory services to their clients.

In some cases, in our view, there is simply no alternative other than to explain why we consider the CSA's proposals to be impractical or incapable of implementation, so in those areas, we do suggest the CSA's proposals be dropped or pared back and the status quo retained. We hope that our comments are taken in the spirit as they are intended – namely to point out where some of the targeted reforms need modification or reconsideration.

Targeted Reform – Conflicts of Interest - Appendix A

12. We have no issue with the principle that all registrants should manage conflicts of interest by prioritizing client's interests and by explaining to clients what conflicts apply and how they are managed to achieve this result. However we ask the CSA consider the following comments:

(a) There is much use of vague and undefined language in Appendix A. The terms "conflict of interest", "material conflict of interest" and "prioritizing the interest of the client" are broad and undefined concepts. In our experience, as lawyers, it is very difficult to explain conflicts of interest in a conceptual way – much less identify circumstances when conflicts exist, except in the most obvious of circumstances. Given the challenges inherent in managing conflicts (although we certainly agree conflicts must be managed), we consider that a uniform and clear definition is in order for the above noted terms. We urge the CSA to provide much more concrete and practical guidance on the meanings of these terms and concepts, so that a better discussion of the principle may be had. We appreciate that the term is defined in National Instrument 81-107. It is highly unclear as to the CSA's concerns about concrete conflicts of interest, beyond "compensation related conflicts" and the distribution of "proprietary products". Both conflicts are easily resolved through clear and concise disclosure. With respect to perceived "compensation related conflicts" in particular, it appears necessary to state that registrants can and should be fairly compensated for their services in general, irrespective of whether or not market investments prove to be profitable as the market performance is beyond their reasonable control.

(b) We note that the guidance in Appendix A appears to permit each firm to define what constitutes a "material conflict of interest", through the guidance that suggests that each firm must develop "a working description of conflicts of interest that enables the firm and its employees (that is, all employees) to understand and identify material conflicts of interest that may arise in a firm's business". This is a very tough job for registrants to do. As the CSA has expressed a broad and general concern about conflicts, we consider that they have a real role in determining a more solid and practical definition capable of implementation in registrants' compliance systems.

(c) The discussion around "proprietary products" is problematic. Firstly, there is no definition of this concept. Equally importantly, we do not understand nor agree with the ultimate conclusion, that disclosure to clients of the relationship between the registrant and the issuer will not likely be sufficient – and that other controls must be put in place to "mitigate" the conflict. The additional controls and even the necessity for the additional controls are undefined and unexplained. Why is suddenly disclosure insufficient to manage this conflict? For years, disclosure has recognized and accepted by regulators as the appropriate technique to manage this conflict. A review of National Instrument 33-105 *Underwriting Conflicts* (one of the most difficult and complex rules in force today) shows that the relationships between registrants and issuers can be very complex indeed, as is the regulation considered necessary to deal with those relationships. Our point is, however, that NI 33-105 uses disclosure as the conflict mitigation technique.

We are particularly troubled by the discussion in the following paragraph which is found in Appendix A (and have highlighted and voiced some of our concerns in bold type)

> *For firms that trade in or advise on proprietary products, the incentive to recommend the proprietary product results in a material conflict of interest which may increase the likelihood that the firm or representative will recommend a product that is not suitable for a client, in breach of its suitability obligation.* **The statement that the sale of proprietary product is a material conflict of interest runs contrary to Appendix D – Know Your Product- Firm** *In addition to ensuring that the products they recommend are suitable for clients, firms and representatives must respond to this conflict with thorough controls that effectively mitigate the conflict, and not rely on disclosure alone to mitigate the conflict.* **To the regulators' knowledge and approval, the sale of proprietary products has been long managed through disclosure** *If the firm or a representative acting on its behalf cannot control the conflict raised by the incentive to recommend a proprietary product, it must avoid the conflict and not recommend or trade the product.* **What does this mean in practical terms when proprietary models or mixed/proprietary models exist? Unless the products are identical, there may be valid reason for recommending one over the other irrespective of associated costs. Additional compensation/benefit/incentives are prohibited by NI 81-105 (in the context of mutual funds).**

We make this comment in the context of the discussion about conflicts of interest – but the spectre of the unexplained problem around distributing "proprietary products" is pervasive throughout the Consultation Paper (and as noted above, some of the CSA's positions about proprietary products are contradictory). We ask at this point that the CSA explain what their concern is with "proprietary products" – and indeed what do they mean by "proprietary products", beyond securities of mutual funds managed by a related entity to the specific dealer, which appears to be the structure that is behind most of the targeted reforms, and a structure that has been long accepted by the CSA.

(d) The concept that a firm and its representatives must have a "reasonable basis for believing that clients fully understand the implications and consequences of the conflict" …notwithstanding the bullet points provided as examples – we consider this is a very difficult (virtually impossible) standard to meet – or to be able to confirm that a representative has met it. A client's perception of understanding will often prevail. We consider this concept undermines the firm and representative's efforts to follow the dictates of the conflicts management regime.

(e) The discussion around conflicts contains a definition of "institutional client" that is different from the definition of "permitted client" in NI 31-103. The CSA have not explained why this definition is necessary, and why it is different from the definition in NI 31-103 of "permitted client" other than to ask the questions about this definition as set out in questions 46 and 47. For the sake of simplicity and to facilitate a registrant's ability to comply with the myriad of rules that apply to registrants, we strongly recommend dropping the new definition in favour of the old definition. We see no reason to have a different term in the area of conflicts (or otherwise with the targeted reforms). We also do not understand these statements in conjunction with the discussion of conflicts (and have again highlighted and voiced some of our concerns in bold type):

> *In the case of institutional clients, unless the interests of the registrant are materially opposed to the interests of the institutional client based on the information the firm and representative have about the institutional client, disclosure alone may be sufficient.* **What does this mean in practical terms?** *However, even with institutional clients, certain situations may arise where there can be no other reasonable response than avoidance.* **What does this mean in practical terms***?*

(f) The discussion around "compensation" appears to be geared in part towards today's compensation models, where fund managers pay trailing commissions and other commissions to dealer firms, as permitted by NI 81-105. We recommend that the CSA not move forward with this discussion until such time as the CSA decide what to do about mutual fund fees after a full consultation on that issue; We also urge the CSA to discuss the various concepts with industry participants to see if these guidelines are even capable of being reasonably incorporated into business practices. The impracticalities of complying with these expectations listed in the bullet points under this heading seem extensive, which include but are not limited to 'specialized measures' forming part of supervisory programs regarding incentives . The fact and reality of compensation, including compensation based on 'sales', cannot in and of itself constitute a conflict.

(g) The discussion around "sales practices" seems to comprise some combination of both the ambit of NI 81-105 and permitted sales practices that are outside of NI 81-105. In particular, the CSA appears to have taken some of the concepts provided for in NI 81-105 and assumed that they can and should apply to other business models and in respect of other securities. No explanation as to specific sales practices are mentioned, other than in very theoretical terms. Further explanation is necessary in this section to ensure an informed discussion may be had in the context of commercial realities.

(h) With respect to 'incentive practices' in particular, we remind the CSA that their concern that incentive practices increase the risk of an advisor making recommendations or accepting client orders that are unsuitable or increasing the volume of transactions in a client's account is mitigated through the obligatory supervisory reviews imposed by the securities regulatory regime as a whole and the SROs in particular.

(i) The discussion around "referrals" includes difficult and unexplained language and currently lacks real world application. For example, what must a representative and firm do when they are referring a client to another registrant to "handle [the referral] in a manner that ensures the sale of securities is suitable for the client"? The whole point of a referral is that the other registrant is responsible for assessing suitability as well as ensuring they know their client, not the original referring registrant. In our view, Division 3 in Part 13 of NI 31-103 is sufficient to deal with referrals and this discussion should be dropped. In addition, it is highly unclear as to why dual licensing or recommendations to invest outside of a security gives rise to a conflict. These matters are in any event outside the jurisdiction of the CSA.

(j) With respect to hiring practices, we remind the CSA of the information that is available to regulators through a Uniform Termination Notice which they have the ability to further investigate and the power to refuse to either transfer or grant registration and/or to impose terms and conditions on the transfer or registration.

Targeted Reform – Know Your Client - Appendix B

13. We understand the importance of the KYC requirement that is the cornerstone of our regulatory regime and allows firms to make suitable recommendations to clients. Appendix B therefore references various aspects of the KYC requirements that have been in place for some time. We are unaware, for example, of KYC processes being limited "to a narrow view of the clients' liquid and financial assets" as stated in Appendix B as that would be offside current regulatory requirements, including those of the SROs. However, our concern with the enhanced guidance in Appendix B is that it amounts to an expectation that firms will collect more information and do the same discovery with a client that a financial planner might do with his or her client, in order to provide the planner with the information he or she needs to develop a comprehensive financial plan for the client.

The expectations in Appendix B are a good example of where we consider that the CSA has supersized the KYC requirements in ways that are "one size fits all" (i.e. every business model, every given client relationship, no matter how simple or limited, will have to follow them) to such a degree that firms will have to decide what level of client to take on (i.e. which clients will allow them to undertake this additional work, presumably for a commensurate fee, and take on the additional liability). We can see where one unintended consequence will be for firms and advisers to limit the types of clients – and asset levels - they are willing to work with (that is, rejecting the smaller investors which may most need assistance from a registrant).

Not all investors may wish to provide this level of information or permit the level of intrusion into their financial affairs, particularly if all they wish to do is invest the annual maximum permitted in registered tax plans (RSPs, TFSA and RESPs).

The concept of registrants being required to collect information about their clients' "basic tax position" is problematic. Generally, many dealer representatives are cautioned against if not prohibited from giving tax advice. They cannot fairly be expected to have the same information available to them as an investor's accountant or tax professional nor can they fairly be expected to have equivalent expertise. If they are not giving tax advice (or cannot give tax advice), what will they be expected to do with this information?

Religious constraints are personal, private matters that investors can and should raise if they feel them to be pertinent. The same applies to "socially conscious investing" and both terms are vague and undefined terms, which mean different things to different people. Registrants can ask about these matters (and particularly some portfolio managers may do this as part of setting an investment policy statement), but we strongly urge the CSA to drop this concept from the KYC process for all registrants as it is both unnecessary and intrusive.

Our earlier comments about the regulators' definitional problems surrounding risk~~,~~ apply to the discussion about risk in Appendix B.

We disagree with the CSA's statement that advisors should "avoid assisting clients respond to questions that relate to the personal preferences of the client to risk". This is not a practical position to take and runs directly contrary to the reasonable regulatory obligations imposed by SROs and NI 31-103 as a matter of necessary inference. Advisors often assist clients in responding to questions that relate to risk (all of which are ultimately a matter of professional judgment by advisors and personal preference by investors) to professionally guide the investor's thought process in an informed and logical manner.

The CSA's paper as a whole does not make any specific allowances for deference to the professional judgement of registrants. In our view, regulators should avoid substituting their own judgement for the professional judgement of registrants except in the most egregious of cases. This position is consistent with the "business judgement rule" that is applied by the Canadian courts of law.

We disagree with the blanket statement that "if the representative encourages the client to increase his or her stated capacity for risk in order to achieve the required rate of return so that the client meets his or her stated investment objectives, this would not comply with the KYC and suitability obligations or the general duties owed to clients". The increase of risk tolerance/profile, on a fully informed basis and in order to attempt to achieve a rate of return is not, in and of itself, unsuitable without further aggravating factors.

We also disagree with the concept that firms and advisors confirm "that the client has a reasonable understanding of the KYC form". This is a vague, subjective concept without any practical meaning, leaving it open for any client to later allege that he or she did not understand, even in circumstances where the representative has documented that h/she asked the question "do you understand?" of the client and the client indicated "yes". We consider that the client has the obligation to inform the firm and his/her advisor if s/he does not understand and to ask questions to help their understanding.

The concept that KYC information must be updated annually for all clients is problematic, particularly in circumstances where the client is making no new investments and has had no material changes in circumstances. Can sending a letter once a year asking a client to review and confirm the KYC be sufficient in these circumstances? Again as investors, we assume that we have a responsibility to monitor our accounts and to ensure that we are comfortable with the performance and level of risk we have taken on. Will all clients be responsive and have the patience or willingness to go over all of the same details with their advisor or representative on a yearly basis? We encourage recognition as to varying client relationships and expectations and the flexibility to meet them in a proportionate manner.

Targeted Reform – Know Your Product – Representative - Appendix C

14. We do not disagree with the concept that a representative must understand what he or she is recommending to their client. It is the supersizing of the existing requirements that we question. We question the utility and realism of the expectations that representatives have in-depth understanding in the ways articulated in Appendix C of each "product" on the firm's shelf – and "how the products compare to each other". We consider that the unintended consequence of this expectation will be that firms will need to narrow the range of products and services to offer to their clients to ensure that KYP expectations of representatives have a hope of being met.

Targeted Reform – Know Your Product – Firm - Appendix D

15. In our view, the entire theoretical discussion in Appendix D will discourage non-proprietary business models or registrants having an extensive range of 'products' on any given shelf, which will have a ripple effect from dealers to representatives to fund managers (particularly fund managers without a related distribution arm) and other product suppliers. The proposals encompass both enormous and impractical requirements which we encourage the CSA to better discuss with industry members. It will limit investor choice. We know this is not the intention of the CSA, who properly favours more investor options.

The proposals appear to give an obvious advantage towards firms which distribute only "proprietary products", in that much of the due diligence required of "mixed or non" firms will not apply. Assuming the CSA articulates its concerns about "proprietary" products (see our earlier comments on conflicts of interest), we wonder why these firms are not required to carry additional due diligence at the very least to ensure that the range of their proprietary products will meet the needs of their clients.

Statements used in the Appendix D around "most likely to", "better" products, "active and passive" investment strategies, "higher or lower cost structures" or "more suitable products" are highly subjective terms without practical meaning and should be dropped from the discussion. They add no additional guidance, are capable of many different interpretations, and will serve instead to confuse the situation making compliance virtually impossible.

Although we feel the language could be improved, we do agree with the concept that an adviser who manages money on a discretionary basis in a managed account will not be considered "proprietary" simply because they invest those assets in a pooled fund that is managed by that adviser or an affiliate of that adviser. However we disagree with paragraph (a) of the definition "managed account pooled fund". Managed accounts and funds are managed by professional advisers (portfolio managers) who exercise professional judgement and have the proficiency expected of portfolio managers. These firms should not be dictated by the securities regulators on processes to such as those set out in Appendix D. In fact we suggest that much of Appendix D should be made inapplicable to registered advisers who manage money on a discretionary basis.

EMDs and scholarship plan dealers will also have a very hard time complying with these requirements. The exempt markets are very different from public markets – and the expectations that EMDs will survey the landscape for appropriate "products" that they can distribute on a prospectus exempt basis in the ways suggested in Appendix D will be problematic (not to mention impractical) and we can see many EMDs simply choosing to distribute only proprietary products.

It is relatively common practice for a fund manager, and in particular, a foreign fund manager, to engage an EMD specifically to help market and sell its funds, because the fund manager is not itself registered as a dealer. Does the commentary in Appendix D require the EMD to canvass the universe of other similar funds that it could offer to its client list (all of which must be capable of acquiring securities pursuant to available prospectus exemptions)?

There is no reason for any KYP process to apply to clients who have waived suitability requirements in accordance with s. 13.3 of NI 31-103 and for any dealer offering execution only services.

Targeted Reform – Suitability - Appendix E

16. We agree with the CSA that in most cases it will be insufficient to conduct a suitability analysis by simply checking that the risk rating of the securities product is consistent with the client's risk profile. We also agree with the concept that firms and representatives should take a portfolio approach to suitability (that is, look at the entire accounts of the client held with the advisor) and that the risk rating of any specific security is only one input in the analysis of-the overall risk of the portfolio held at the firm.

We also agree with the CSA that in determining-suitability, only the information relevant at the time of the suitability analysis will be taken into account by the regulator. We agree that subsequent events, and in particular, poor performance, will not inform whether a suitability analysis at the given time met regulatory requirements.

Although both of the above are reasonable expectations we note that neither are applied by some regulators or the OBSI on a consistent or other basis.

17. However, notwithstanding the above, in our view, the additional expectations set out in Appendix E, when coupled with the KYC and KYP expectations (commented upon above), will mean that every client will need to undergo, in essence, some form of a financial plan with their dealer (of any category) or adviser. This just does not make much sense, particularly for smaller investors who simply want to make an annual contribution to their RSP or to save for their child's education in an RESP or invest in an exempt market security, such as a private equity fund. This is another example of the "one size fits all" approach inherent in the targeted reforms. As with other targeted reforms, the expectations set out in Appendix E will very likely cause firms to limit the numbers and types of clients they take on – simply because to carry out all the procedures expected will increase costs and administrative burden and lead to greater compliance and business risk, which may not make economic sense for the firm if the account size is too small and the client has not sufficient money to invest.

18. Additional concerns with the proposals described in Appendix E are as follows:

(a) Registrants must formulate a basic asset allocation strategy – and work with the client to set an "expected risk-adjusted rate of return sufficient to meet the client's investment needs and objectives" - in our experience regulators have always properly discouraged firms from doing this as market returns are not predictable – this is the essence of the capital markets. Indeed, section 38(2) of the *Securities Act* (Ontario) specifically prohibits a representation regarding the future value of a security being sold. Will a client understand the difference between "setting an expected rate of return on an investment" and an "undertaking as to the future value" of that security? We consider the risk, that a client, the OBSI (and a court) may take this to be a form of "guarantee", to be very high.

(b) The CSA explain that investments should not exceed "reasonable concentration limits" for an asset class and investments beyond 10 percent of a client's assets would be considered unduly concentrated. With respect, this is substituting regulatory opinion for professional judgement and will limit investor choice. Is there empirical evidence that less concentrated portfolios generate higher returns and/or are appropriate for all investors?

(c) Registrants also must identify a target rate of return and assess the target rate of return against the client's risk profile. So long as clients are informed and warned about a higher degree of risk (and this warning is documented), clients have the right to decide for themselves what risk they are willing to take on so they can have a hope of meeting their financial needs.

(d) The discussion about circumstances when a representative should advise a client not to invest (for instance pay down debt or buy insurance) will not be practical or even possible to administer and we recommend these concepts simply be dropped. This is delving into areas outside the jurisdiction of the CSA and there is no evidence that this will provide a net benefit to clients over the long term. One can see where a client will be offended when they are told they cannot make an RSP contribution, but instead should pay off their student loan, their mortgage, their credit card debt – etc. Similarly, why would a representative be expected to refer a client to a provider of an "insurance or banking product"? In our view, the advice on banking and insurance is beyond the jurisdiction of securities registrants and the securities regulators – and this guidance should be dropped. A securities registrant is not qualified to give advice on whether an insurance or banking product or service would be more suitable for the client than the securities services being offered by the representative.

(e) Similarly, although we agree that recommended 'investment strategies' should be subject to a suitability review, these investment strategies must inevitably involve a securities transaction to be subject to securities regulatory expectations.

19. We also have trouble understanding the following concepts described in Appendix E:

(a) What does it mean that if a product "benefits" the firm, but not the client, the CSA would consider that the recommendation would not be suitable. Does this mean the firm/representative would be liable if gets paid on an investment that loses the client money? Again the potential to lose money is inherent in the capital markets and no regulation can take that risk out of the market.

(b) What does it mean for a product to be more "costly" than another, such that the recommended product would be not suitable for the client. Why not? Why is this always the case? Unless the products are identical in every way, a general comparison based on the wider concept of suitability and costs is not appropriate.

(c) We note the requirement to conduct a suitability review upon a "significant market event". Significant market events that may impact market returns are inevitable and to be expected. They do not mean that the underlying quality of the securities a client holds has invariably changed or that every client of every profile and business model must invariably be contacted for the purposes for conducting a suitability assessment or that a hold recommendation should be suspect or unsuitable in declining market.

20. We continue to encourage flexibility in the approach to suitability reflective of differing business models and registration categories. We encourage the CSA to explicitly recognize that the scope and nature of a client relationship differs in any given circumstance based upon a number of factors including registration categories and the clients profiles and expectations within those categories. For example:

(a) If the firm is an EMD and the client has made one investment through that EMD – what is the firm expected to do to assess suitability on a continuous basis?

(b) The guidance should not apply to registered portfolio managers, who are subject to fiduciary duties and therefore should be able to determine what they need to know about their client to develop a detailed investment policy statement and to understand the constraints in investing the client's assets.

Targeted Reform – Relationship Disclosure

21. We strongly agree that a significant role of the CSA should be to mandate clear and plain disclosure and we do not have any objections to "relationship disclosure" in principle (although we have always felt that the term "relationship disclosure" is not a particularly plain language term that is understandable by investors or makes the document inviting for easy reading). We also have no objections to the CSA requiring a firm to disclose whether they sell their own managed products or a mixed shelf. However, we do recommend that the CSA carry out some targeted investor research to see if the terms "proprietary" or "mixed/proprietary" "non proprietary" are meaningful to investors. These terms may have more regulatory meaning as opposed to being meaningful and plain to investors.

However, we completely object to the concept that firms "should have a reasonable basis" for concluding that a client fully understands the implications and consequences for the client of the content being disclosed. This is virtually impossible and again the CSA would be setting registrants up for failure if this concept were retained. For instance, does this mean that firms will be expected to test their disclosure with clients or potential clients in some form of market research, with requests that clients respond back with answers to scripted questions designed to test whether they understand the disclosure?

Targeted Reform – Proficiency

22. We agree that registrants should be subject to standards of professionalism. It is difficult to comment on the proposals as they relate to increased proficiency, since there is little detail in the CSA's proposals. What will mandated increased proficiency mean for the different categories of registrant? Additional courses? Internal training? Professional designations? The concept of "proficiency" is of course a cornerstone of all professional activities, including in the financial services arena – but the CSA should not leave the requirements as vague as they are written in the Consultation Paper. In answer to question 29, the CSA should not attempt to dictate what proficiency a UDP of a securities firm should have – to our mind this would be a wholly unwarranted regulatory intrusion into business affairs. CCOs are already required to have specified proficiency. If there is a perceived problem with UDPs and CCOs, then the CSA is urged to articulate this.

Targeted Reform - Titles

23. While we agree there is room for agreement on specific titles for representatives, and we understand the desirability of minimizing confusion and misunderstandings on clients, we simply do not understand the perceived problems with a dealing representative (IIROC or MFDA firm) calling themselves an "advisor". These individuals provide advice on

financial matters to clients. We believe the CSA should provide guidance on expectations or concerns– but should not mandate specific titles and should reject the concerns that are raised by some investor advocates about the use of the term "advisor". Representative's roles are much more than simply "selling" securities and we believe this is an accepted term that has an understood meaning for clients. We make this comment given the CSA's proposal that individuals who are with firms selling proprietary products can only call themselves "securities salesperson". In our view, these individuals also provide a valuable service as an "advisor" and should be permitted to use this title.

If the CSA really feels it important to mandate titles – they should allow for accurate and plain meaning titles that have meaning for clients. For example, the term "securities advisor – portfolio management" is long, awkward and not particularly meaningful, whereas the term Portfolio Manager has a meaning that is easy to grasp.

Individuals should also be permitted to hold out their position within the firm – as a director, executive officer, vice-president and otherwise. If they are also "advisors" or portfolio managers, this should be also plainly stated.

We also consider that firms should have choice on what they wish their representatives to be called – a plain use of the term "representative" should also be acceptable and we recommend this be permitted, given that it is the term used by the CSA.

Targeted Reform – Statutory Fiduciary Duty When Client Grants Discretionary Authority

24. We have no comments on the notion that firms that manage other people's money on a discretionary basis should be subject to a fiduciary duty that is embedded in securities regulation, although we fail to understand why the securities legislation has to be amended to provide for this. Could this not be made a rule of the applicable CSA members, in ways that was done for investment fund managers in NI 81-107? Could the CSA not continue to rely on the common law? The hierarchy of legislation and rules may be behind the CSA's plans in this area, but we do not immediately understand why this cannot be done by rule-making if the CSA wish to have more defined standards and the ability to take action against a breach of securities legislation rather than relying on the common law. This would make the proposals subject to industry comment and subject to the rule-making procedures.

Targeted Reform – "Regulatory" Best Interest Standard - Appendix H

25. There is no need for an overarching "regulatory best interest standard" that would apply to all registrants and all representatives, for the reasons we will set out below. Although we hasten to add that we are certainly not against the *concept* that registrants should provide services to their clients in ways that prioritizes the clients' interests. We do not disagree that this is an overriding objective of securities regulation – we strongly however, question the need for this to be a standard - and described as a "best" interest standard - which would be written into rules, particularly in the ways suggested in the Consultation Paper.

A few preliminary comments before we provide our views on the concepts set out in Appendix H.

(a) As above, we don't particularly understand the concept of a "statutory" duty versus a "regulatory" standard. We note that the discussion in Appendix H refers to a "legislative" standard, which we did not understand a "regulatory" standard to be. We especially do not understand what a registrant who exercises discretionary authority would be required to do to comply with the above-noted "statutory fiduciary duty" and also the "regulatory" best interest standard, assuming they fall within the type of registrant that the former standard would apply to. Why the two standards for those exercising discretion? What else would a firm and a representative be required to do to comply with the latter, if they are complying with the former? We also note that there are several spots in Appendix H which assumes any registrant would comply with both standards. To leave this unexplained and vague is to invite confusion for the OBSI, the courts and other judicial tribunals to sort this out~~,~~.

(b) It is unclear to us what would be the "standard" (that would be embedded into the rules) and what would be the guidance as to what the CSA thinks this standard means. We are assuming that the first sentence in Part 2 of Appendix H would be the standard to be embedded into (presumably) NI 31-103, with the balance of Appendix H as Guidance and CSA commentary (as CP discussion).

26. When we review the proposed Guidance contained in Appendix H, we have the following comments:

(a) It is very challenging for us as lawyers and the various registrants who are our clients to submit comments to the CSA that could be interpreted as being against the CSA's goals to enhance investor protection in the ways proposed by the CSA. It is important for us to emphasize that we are commenting on the notion of embedding a new, undefined standard of care into regulation, which we – and the various members of the CSA - would not be able to meaningfully explain how this standard could be met. It cannot be over-emphasized that even with the extra guidance provided in Appendix H – the only way this standard will be tested is by the OBSI or in a court of law or judicial tribunal which would look at specific circumstances and facts, often many years after the circumstances took place. In our view, this standard, with the guidance provided in Appendix H, would mean that either the OBSI or a judicial tribunal would be hard pressed not to rule in favour of clients – even if there is a reasonable argument from the registrant that they were acting in the client's interests and were otherwise complying with all other regulatory requirements.

(b) We do not see how such an untested and vague standard could provide a more objective, client-centered standard of care than having to deal fairly, honestly and in good faith. If the CSA are exasperated with the current level of compliance by registrant firms with existing regulations, we fail to see how raising the expected standard of care, rather than better enforcing the existing rules, will achieve the stated goals.

(c) We also question the assertion that a principle-based approach, allegedly through the adoption of the concepts in Appendix H, allows greater flexibility for registrants. In fact, it will only really allow greater flexibility for regulators and judicial tribunals and in our experience will lead only to greater uncertainty in the industry.

(d) Similarly, the assertion that such a standard would have immediate impact and allow for swifter regulatory action is also troubling. Our concern is that it will more likely lead to arbitrary and inconsistent application by individual CSA representatives, SROs and the OBSI.

(e) The common law that is applied by courts is informed by regulatory standards which influence the courts. In other words regulatory standards cannot be separated from “law”. The statements by the CSA in Appendix H under the heading “relevance of other legal obligations”, are perfect examples of where regulatory duties and standards are intertwined with common law.

(f) The terms “best interest of clients” and “prioritizing a client’s best interest” are used throughout the Guidance, without any attempt at definition. These are subjective terms that will be considered and defined by a judicial tribunal – considerably after the fact – and in light of circumstances, but which cannot be easily translated into compliance programs or meaningful guidance and policies and procedures of registrants.

(g) When a firm and representative is asked to interpret law and agreements with clients in a manner favourable to the client’s interest where reasonably conflicting interpretations arise, we point out that the highlighted term is highly subjective and views may differ widely as to whether a client’s interpretation is reasonable. Disputes almost invariably involve issues of credibility as between representatives and clients, with each potentially consciously or unconsciously motivated in their interpretations and recollections. Law and agreements are interpreted in accordance with objective legal principles which assume fairness for society at large. There is no need for investors to be treated differently (that is, in contrast to insurance contracts which are to be interpreted in favour of the policy holders under long-standing insurance law principles for good public policy reasons). This concept, in our view, cannot be objectively implemented and has the ability to render nugatory any documentation including completed KYC forms and relationship disclosure that is mandated by the CSA.

(h) Language used by the CSA is also fiduciary in nature (although the CSA is at pains to explain that the “best interest” standard is not a fiduciary standard) – for example “achieving what is best for their clients, including placing the interests of their clients ahead of their own” and the above-quoted clauses regarding interpretation of agreements is language that is fiduciary in nature.

(i) What is a “foundational standard of conduct” and what does it mean to use this standard to consider and evaluate “conduct in new and unforeseen client situations"? This is an impossible matter to explain to registrants and their representatives.

(j) We do not understand why the CSA has sought to apply this standard across registration categories and business models except for underwriting activities, corporate finance advisory services, controlling shareholders or persons seeking to influence control of an issuer. For example, it clearly should not apply to discount brokerages. In addition, registrants in a fiduciary relationship are being incorrectly held to the same standard as those who are not. A similar standard of care is being applied to accredited investors, permitted clients, institutional clients and clients who are not otherwise relying on advice as is being applied to clients with little to no investment experience who are wholly reliant on their advisors. We continue to emphasize that the extent and content of any standard of care differs with the nature of the client relationship.

27. In conclusion, though we recognize that the CSA has stipulated that the proposed standard of care is not intended to interfere with registration categories, guarantee that clients' securities investments will never lose value, result in the best or highest returns for the client or in the lowest risk to the client or interfere with the courts' ability to apply common law principles, we are of the strong view that it will inevitably have all of these unfortunate consequences.

We thank you for allowing us the opportunity to comment on the proposals set out in the Consultation Paper. We have annotated the various Appendices attached as proposed guidance to the Consultation Paper pointing out problematic clauses (consistent with our comments contained in this letter) and would be pleased to provide CSA staff with these annotations if this would assist staff in better understanding our comments.

Please contact any of the following lawyers at the contact details provided below if the CSA members would like further elaboration of our comments. We, together with other BLG lawyers who have considered the Consultation Paper, would be pleased to meet with you at your convenience to discuss any of the concepts covered in the Consultation Paper and the CSA's considerations of comments received. At least some of us plan to attend the December Roundtables and appreciate the fact that these have been organized.

Yours very truly,

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