Desjardins

September 30, 2016

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

Anne-Marie Beaudoin
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Josée Turcotte, Secretary
Ontario Securities Commission
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Subject: Comments from Desjardins Group on *Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*

Dear Ms. Beaudoin and Ms. Turcotte:

Desjardins Group (DG) would like to thank the Canadian Securities Administrators (CSA) for the opportunity to react to their Consultation Paper 33-404, which proposes regulatory measures to reconcile the interests of advisors/dealers and their clients, and to improve the relationship between them. With the same goal of improving the client-registrant relationship, the Consultation Paper recommends introducing a regulatory best interest standard, which was the topic of a similar consultation in 2013.

DG was surprised to read the lengthy Consultation Paper, which addresses a number of topics and issues that are very broad and/or factual. This consultation seems premature when, as part of the Client Relationship Model Phase 2 (CRM2) and the new point of sale disclosure for mutual funds, those subject to them are in the process of implementing or have just implemented new rules with the same goals, which we still do not know the impact of.

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It would seem more advisable to evaluate the impact of recent major regulatory changes, which required significant investments and adjustments, and which undoubtedly respond to some of the CSA's concerns in this consultation.

While there is always room for improvement, it seems as though the CSA, through its many back-to-back and even overlapping initiatives in recent years, is seeking absolute regulatory solutions, when there will always be uncertainty when it comes to financial market transactions and business relations in which every party should benefit. Can we inject some stability into the field of securities for a little while?

Nevertheless, DG is submitting its comments on some of the CSA's questions, the complete list of which is in Appendix I of the Consultation Paper.

Desjardins Group at a glance

With assets of $260.7 billion, Desjardins Group (DG) is the largest cooperative financial group in Canada and the sixth largest in the world. To meet the wide-ranging needs of its 7 million members and clients, both individuals and businesses, it offers a full line of products and services through its extensive point-of-service network, virtual platforms and subsidiaries across Canada. It operates in the following sectors: Personal and Business Services, Wealth Management and Personal Insurance, and Property and Casualty Insurance.

Drawing on the strength and skills of 48,000 employees and the commitment of 4,800 elected officers, DG was named one of the Best Employers in Canada by Aon Hewitt more than five years running. Ranked fifth among the strongest banks in the world and first in North America in the 2015 *World's 20 Strongest Banks* by the financial agency Bloomberg, DG has one of the best capital ratios and credit ratings in the industry.

In 2013, the Autorité des marchés financiers (AMF) designated DG a domestic systemically important financial institution (D-SIFI).

The DG subsidiaries particularly affected by this consultation are Desjardins Securities Inc. (DS), Desjardins Financial Services Firm Inc. (DFSF) and Desjardins Financial Security Investments Inc. (DFSI).

DS is a full-service brokerage firm registered with securities authorities in every province and territory of Canada. It has over 300 investment advisors and assets under management of more than $25 billion.

DFSF is a national mutual fund dealer and financial planning firm registered in Quebec. Its 8,000 advisors do business mainly in Desjardins caisses in Quebec and Ontario.

DFSI is DG's independent brokerage network for the distribution of mutual funds. Doing business in Quebec and part of New Brunswick under the name SFL Investments, it operates in every province and territory in Canada. DFSI has close to 1,300 advisors, and assets under management are $11.75 billion.

DS is a member of the Investment Industry Regulatory Organization of Canada (IIROC), and DFSF and DFSI are both members of the Mutual Fund Dealers Association of Canada (MFDA).

1. Comments on proposed targeted reform

To summarize, the reforms proposed by the CSA cover the following topics:

- Improved conflict of interest provisions that require advisors and firms to resolve conflicts by putting the client's interests first
- More specific obligations with respect to collecting information from the client, including the type of information to gather and the frequency of updates
- An independent know your product obligation, including, for firms, product list obligations
- Assessment factors for suitability
- The information that firms that offer only proprietary products must provide clients
- The use of titles in the client relationship.

We believe that IIROC and the MFDA already enforce a number of these "new" obligations for investment dealers and mutual fund dealers.

Here are a few responses and observations related to questions posed in the Consultation Paper. We have grouped them by topic for easier reading.

1.1 General obligation for conflicts of interest

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

As indicated in previous consultations, particularly the consultation on introducing a fiduciary duty (33-403), we believe that the Quebec legislative framework, section 13.4 of *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("Regulation 31-103"), MFDA Rule 2.1.4, IIROC Rule 42 and the advisors' code of ethics are adequate and sufficient to determine how conflicts of interest should be handled. The AMF's *Sound Commercial Practices Guideline*, which applies to DG because of its status as a domestic systemically important financial institution (D-SIFI), is also in line with this perspective in that it outlines expectations about the fair treatment of consumers.

Furthermore, with CRM2 and Point of Sale, mutual fund advisers, dealers and representatives have already had many measures imposed on them for this purpose. New ones could accomplish the opposite of what is intended and create another type of conflict of interest, since advisors would be tempted to recommend products that are not as highly regulated. This type of service offer could be contrary to the clients' interests, because their needs might not be fully met. This could introduce disequilibrium into the financial services industry. We might also see an increase in the number of advisors who relinquish their securities licence, particularly older representatives.

Question 46. *Is this definition of "institutional client" appropriate for its proposed use in the Policy Statement? 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 Policy Statement 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 Consultation Paper proposes the idea of "institutional client" in the Policy Statement to Regulation 31-103. Firms that deal with "institutional clients" will be released from certain obligations, namely the obligation to evaluate the client's suitability and knowledge, the obligation to inform the client that it offers solely proprietary products and the obligation to inform the client about its restricted registration. Furthermore, a simple declaration would be sufficient to resolve conflicts of interest that are not clearly contrary to the interests of the institutional client.

We believe that introducing a new definition for "institutional client" creates too much complexity in the application of the regulation for registrants who are also members of IIROC. Regulation 31-103 provides exemptions for "permitted clients" (except, if applicable, permitted clients who are individuals or in the case of managed accounts), and IIROC rules provide exemptions for "institutional clients."

We are concerned that the addition of a new category of exempted clients creates more confusion because there are already several categories of exempted clients. We should also note that there are currently the concepts of "accredited investor" and "eligible investor" in *Regulation 45-106 respecting Prospectus Exemptions*, and "accredited counterparty" from the *Derivatives Act*. Several of these definitions overlap, and the wide range of concepts makes them difficult to apply.

We therefore believe that the introduction of a new definition is not justified and would cause more confusion among registrants, particularly those who are subject to the rules of self-regulatory organizations such as IIROC. At this stage, we should be harmonizing the different categories of exempted investors to avoid confusion in applying the different definitions.

The current threshold of assets for an individual set out in the definition of "permitted client" in Regulation 31-103 is $5 million dollars, and the current asset threshold for an individual set out in IIROC Rule 1 in the definition of "institutional customer" is $10 million. The proposed threshold of $100 million is 10 times higher than the current threshold in IIROC rule. We believe this threshold is too high for the purpose of protecting investors, particularly vulnerable and uninformed investors.

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

Question 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?*

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We believe that prohibitions and restrictions on commercial practices (Regulation 81-105) should not be limited to mutual funds, but should apply to all types of products.

1.2 Know your client

Question 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?*

Question 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?*

Currently advisors do not necessarily have the skills to understand clients' tax positions or offer tax planning services.

The education and experience requirements of Regulation 31-103 do not include an understanding of the client's tax situation. We believe that training on taxation should not be imposed on advisors, because they do not provide tax planning services. This additional know-your-client obligation and training could create the false impression among clients that tax planning is part of the mandate of advisors and their firm and that advisors have the knowledge required to assess their tax situation.

We believe that tax planning advice should be given only by tax specialists.

We also believe that these additional know-your-client obligations, including understanding the client's tax situation, should not apply to all registered firms, for example, firms that offer only execution order services without advice that are exempted from the obligation to evaluate suitability. The requirement to understand the client's tax situation is not useful in terms of the role of these registered firms.

Question 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 disagree with this proposal because it would create too much formality and would not foster business models that meet the needs of different clienteles. For example, the MFDA submitted a form template, but withdrew it because of the difficulty of universal application.

Question 6. *Should the KYC form also be signed by the representative's supervisor?*

We are in favour of a supervisor checking the KYC information. However, the obligation should be drafted to offer the flexibility to exploit the possibilities that technology offers.

1.3 Know your product – representatives' obligations

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

The CSA's proposal would impose the following obligations on advisors:

1. Understanding the structure, features, strategy, costs and risks of each product that their firm trades or provides advice about and be able to compare products
2. Understanding the structure, features, strategy, costs and risks of each product that they recommend their clients to buy or sell
3. Understanding the impact of fees associated with the product, the client's account and the investment strategy.

We agree with paragraphs (2) and (3) above, but not with paragraph (1). An advisor cannot know all of a firm's products because there are too many of them. For example, advisors at certain DG subsidiaries distribute the products of more than 80 fund companies that each offer dozens or hundreds of funds.

We believe that the know-your-product obligation should be interpreted in light of the suitability obligation and that it is neither justified nor necessary to require representatives to know inside and out all the products their firm trades and that are on the firm's product list. Section 13.3 of the Policy Statement to Regulation 31-103 stipulates that "to meet this suitability obligation, registrants should have in-depth knowledge of all securities that they buy and sell for, or recommend to, their clients." We believe that this requirement is sufficient for assessing suitability.

Furthermore, IIROC published Guidance Note 09-0087, requiring that its members form a committee to study and approve new products. The MFDA did likewise in its Staff Notices MSN-0048 and MSN-069. As a result, we believe that additional know your product obligations are not required since new products offered by registered firms are already subject to internal controls by IIROC and the MFDA. However, we are in favour of measures to ensure a level playing field.

It is clear that if the initiative from paragraph (1) is adopted, this "expanded" know your product obligation would prompt firms to limit their product offering to enable their advisors to meet this new requirement. How is this beneficial to clients?

1.4 Know your product – firms' obligations

Question 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.*

Question 61. *Is the expectation that firms complete a market investigation, product comparison or product list optimization 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.*

We believe that the registered firm must know the market and similar, competing products. That said, the proliferation of products makes this difficult to do, and a new obligation to conduct a market study and a product comparison would require ongoing investigation. The costs associated with such an investigation could be significant, particularly since the information on products can be hard to find. We are concerned that the requirement of ongoing investigation would stifle healthy competition among institutions.

In fact, firms could drop their mixed/non-proprietary products for fear of being subject to the ongoing investigation obligation. If this were to happen, this measure would not protect investors or foster market efficiency. Since members of IIROC and the MFDA already have internal controls for selecting products, the obligation to conduct a market investigation should not apply to them.

Question 9. *Do you think that requiring mixed/non-proprietary firms to select the products they offer in the manner described will contribute to this outcome? If not, why not?*

Question 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 obligation for firms to select products in line with policies and procedures that require a fair, unbiased market investigation for a reasonable group of products for which they may provide advice or conduct trades by virtue of their registration should be clarified. This should include additional information about conducting a "fair and unbiased market investigation."

While we understand the idea behind the concept, this requirement seems cumbersome, and the process needs to be streamlined.

1.5 Suitability

Question 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?

At first when reading the Consultation Paper, we understood that it would not be sufficient that the product be suitable for the client and that it should also be "most likely to achieve the client's investment needs and objectives." It was only after a discussion meeting with the AMF about these consultations that we understood that more than one product could meet this criterion for a client and that the phrase is not synonymous with the "best product." Given the vagueness and confusion this idea generated with the majority of participants in this meeting, we recommend instead using the phrase "reasonably likely to achieve" to limit ambiguity that could lead to lawsuits or class actions by clients who would try to prove that the best product was not offered to them.

Question 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?

Investors' investment horizons are often medium or long term. A formal update every year, with the client's signature would therefore be unduly demanding for the majority of clients and advisors. This requirement could limit access to advice for small investors.

To reconcile the CSA's concerns with the reality of the client-registrant relationship, we recommend instead a requirement to update the information on the client's account any time there is a significant change to the client's situation. The registered representative would have to regularly ask clients if their situation has changed. They can also ask about changes when they meet to review the portfolio. Also, in the documentation for opening an account, the firm has to clearly inform clients of their obligation to notify their advisor when their situation has significantly changed. Obviously, advisors should evaluate the suitability of the portfolio as soon as they become aware of a relevant change to the client's personal or financial situation.

1.6 Information on the relationship

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

We are not against the idea of telling clients that the advisor can only recommend certain products because of his or her registration. This could prevent errors of perception by the client and more clearly define the spirit of the client-registrant relationship.

1.7 Proficiency

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

An obligation for professional development for advisors, particularly on the main regulatory obligations such as suitability, know your client, know your product and conflicts of interest, as well as in ethics, is entirely appropriate. In Quebec, professional development in the mutual fund sector is particularly well established. The MFDA is also working on a professional development system, and we applaud the initiative.

IIROC requires its members to pursue professional development. We believe that the proficiency requirements and barriers to entry are well defined. The CSA should instead concentrate on maintaining this proficiency through professional development. Additional training on ethics and conflicts of interest would also be useful to make registered firms and their advisors aware of the current system to act in the client's best interests and their obligations.

1.8 Professional titles and designations

Question 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?

We agree with the observation that the range of professional titles used by advisors causes confusion with respect to the proficiency of advisors and their position and responsibilities within firms. Therefore, we need to define the use of professional titles.

For example, we propose that portfolio managers and investment dealers acting on a discretionary basis be called "portfolio managers," and we agree that those who are operating without a discretionary mandate be called "securities advisors." However, we believe that the title "securities salesperson" does not convey the advisory role or the advisor's skills.

As for alternatives proposed by the CSA, we prefer Alternative 3, according to which advisors could use only their registration category, for example, dealing representative or advising representative. The disclosure of types of products that can be sold to clients should be sufficient. To keep things simple, the title "mutual fund representative" should also be permitted when it is used in conjunction with the name of the dealer sponsoring the person.

To reflect the value of advice and the client-registrant relationship, the use of the title "mutual fund advisor" should also be recognized. The other two alternatives that use the term "salesperson" are simplistic, do not reflect the value of advice and therefore should not be used.

We should also note that the use of "restricted securities advisor," proposed in Alternative 1, could give clients the impression that the mutual fund dealer representative's proficiency has decreased or that he or she has been subject to specific regulatory measures.

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?

We believe that titles unrelated to expertise (e.g. vice-president) do not help clients understand an advisor's role or skills, and may even give them the false impression that the advisor has an important position within the firm. As such, the use of such titles should be limited.

2. Comments on proposed regulatory project to act in the client's best interests

Question 36. Please indicate whether a regulatory best interest standard would be required or beneficial, over and above the proposed targeted reforms, to address the identified regulatory concerns?

The standard to act in the client's best interests is already set out in the provisions of the *Civil Code of Québec*, the *Securities Act*[1] and by IIROC Rule 42, MFDA Rule 2.1.4, section 13.4 of Regulation 31-103 and the AMF's *Sound Commercial Practices Guideline*. The jurisprudence regarding obligations resulting from the standard to act in the client's best interests is based on the interpretation of these provisions.

Introducing a similar obligation could create legal uncertainty about the applicability of existing jurisprudence and the scope of the obligation of advisors and firms to act in the best interests of their clients. For details, we refer you to our comments submitted as part of consultation 33-403 regarding the introduction of a fiduciary duty.

The introduction of such a standard is therefore unnecessary, and unexpected consequences could result from it. The concept of the standard is vague, which explains the lengthy document produced by the CSA. The application would become discretionary and difficult for firms to oversee. As a result, the proposed targeted reforms are sufficient, if needed.

3. Impact on investors, registrants and financial markets

Question 39. What impact would the introduction of the proposed targeted reforms and/or a regulatory best interest standard have on compliance costs for registrants?

Question 41. What challenges and opportunities could registrants face in operationalizing i. proposed targeted reforms; and ii. a regulatory best interest standard?

The impact of introducing these targeted reforms and/or a new regulatory standard to act in the client's best interests could be significant for advisors and firms, because they have just completed or are in the process of completing the implementation of CRM2, a costly operation, both in terms of IT systems and hiring human resources.

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[1] Section 159.3: "An investment fund manager shall, in the best interests of the fund and its beneficiaries or in the interest of the fulfillment of its purpose, exercise prudence, diligence and skill, and discharge its functions loyally, honestly and in good faith."

It would be a good idea to understand the impact of CRM2 and the new Point of Sale system before implementing new major measures for advisors and firms.

The targeted reforms can also pose challenges in terms of costs and opportunities. Some of these reforms, particularly the obligation for firms with a list of mixed and non-proprietary products to conduct a market analysis could limit healthy competition between institutions that serve both clients and society.

We believe that IIROC and MFDA rules already cover a number of these obligations. For example, IIROC Rule 42 sets out the obligation to settle conflicts of interest and imposes the obligation to act in the client's best interest. The AMF's *Sound Commercial Practices Guideline* sets out requirements for the fair treatment of consumers, including managing conflicts of interest. The provisions of the *Civil Code* and the *Securities Act* also set out similar obligations that apply to many types of intermediaries, including some advisors and firms.

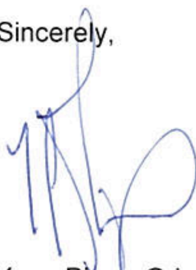
Imposing a regulatory standard to act in the best interests of the client would create uncertainty as to the interpretation of these codified rules and would cause confusion for advisors and firms about the scope of their obligations to the client.

We also agree with the AMF's[2] reservations about introducing a regulatory standard to act in the client's best interests:

- A possible increased gap between the clients' expectations and advisors' obligations
- A source of legal uncertainty (through its lack of clarity and precision)
- Untested effectiveness of CRM2 and the Point of Sale initiative both of which are intended to improve communication in the client-registrant relationship with respect to the cost and performance of investments
- Possible impact on the interpretation of current fiduciary standards for certain advisors and firms.

Please contact the undersigned for clarifications or more information.

Sincerely,



Yvan-Pierre Grimard
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[2] AMF presentation – CSA Consultation 33-404 on proposals to increase the obligations of advisors, dealers and representatives to clients – Discussion meeting held by the AMF's Direction de l'encadrement de la distribution, June 17, 2016, page 31.