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Delivered By Email: consultation-en-cours@lautorite.qc.ca, comments@osc.gov.on.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

ATTN:

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Ontario Securities Commission
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Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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RE: Response to CSA Notice and Request for Comment: Canadian Securities Administrators Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Towards Their Clients

Arrow Capital Management Inc. ("Arrow") supports the CSA's objective to improve the relationship between clients and their advisers, dealers and representatives. Arrow has reviewed and provided commentary directly to AIMA Canada's Legal & Finance Committee's submission on the CSA Consultation Paper 33-404. Arrow feels particularly supportive of AIMA Canada's response to the CSA's question on whether the proposed approach to regulating how representatives should meet their KYP obligations:

"AIMA Canada has <u>significant and grave</u> concerns for the approach to KYP obligations for both representatives and Firms as currently set out in the Consultation Paper. We feel that the implications of the KYP obligations on both individual representatives and Firms would have a disastrous impact on the ability of alternative investment fund managers who seek to distribute their products through other registered dealers (such as IIROC or bank-owned dealers).

In essence, the proposed KYP obligations would require each individual representative of a dealer to "understand the specific structure, features, product strategy, costs and risks of each product their firm trades or advises on". This obligation on a representative to understand a firm's entire universe of investment products is unprecedented and counter to investors' best interests. In the abstract, the proposal has appeal: shouldn't a representative have a strong working knowledge of every single fund on a dealer's shelf in order to pick the best option for his or her client? However, the reality is that dealers (especially larger IIROC dealers) have created comprehensive and expansive product shelves in order to serve a large and diverse investor base in many different communities across Canada. For example, a dealer might approve a similar strategy run by reputable investment managers in several different cities so that representatives across the country can establish strong relationship with local investment managers, including giving investors direct access to those investment managers. A large shelf also serves to mitigate risk for investors and the dealer through a diversification of managers on the basis that more choice is good for investors.

In the experience of AIMA Canada members, representatives use the initial due diligence conducted by the dealer during the shelf approval process as a starting point. They then supplement it with their own due diligence, thoroughly vetting the approved fund managers. The choices made as a result of this "double due diligence" process has served clients well. A double due diligence process would be practically impossible for an individual representative to conduct on an entire shelf of investment products.

Even if the due diligence process was less time consuming, it is not realistic to expect a representative to conduct an extensive review of an entire product shelf. Any representative attempting to do so would be forced to sacrifice investor service levels. And it isn't necessary for a representative to have an encyclopedic knowledge of every fund offering. He or she must be able select funds that suit investor needs and ensure that they have not overlooked a similar fund offering with a strong comparative advantage.

In response to the proposed new obligations, representatives will either reduce their own due diligence process or they will not engage in a "deep dive" on every fund on the shelf. The first response is bad for investors; the second is bad for dealers from a regulatory risk perspective. These practical realities are well understood by dealers. We strongly expect that the proposed new KYP obligations will cause large IIROC dealers to limit the number of investment choices on their shelves in order to reduce the potential for liability.

Much of the volume of retail securities transactions is concentrated with a few large dealers. Any limitation by those dealers on investment choice will have an out-sized impact on investment fund managers. We submit that the requirement on dealers to offer a "reasonable universe of products" is a difficult standard to apply and enforce and consequently will not have an impact on an inevitable shelf culling.

In other words, the number of investment funds offered to Canadian investors will shrink dramatically. Limiting investment choice is an unintended consequence. It is directly contrary to the spirit of the proposed rules. It is also contrary to the objectives of the recently published proposed amendments to National Instrument 81-102 - Mutual Funds and related National Instruments which seek to expand the asset classes available to Canadian retail investors. Investors offered less choice are subject to: (i) higher fees; (ii) poorer performance; (iii) less variety and lack of manager diversification; and (iv) reduced innovation. The investment fund managers most likely to be disproportionately impacted by the proposals are those that offer a small number of funds. That is because the due diligence process is made much more efficient for the dealer if it can conduct a review of one manager that offers a 100 funds as opposed to 3 funds. However, funds offered by smaller investment managers are often the most innovative and arguably deliver the best value to investors.

Instead of subjecting investors to these risks, AIMA submits that the CSA should provide guidance to dealers on what constitutes reasonable due diligence of investment fund products and to recommend that dealers provide regular periodic lists and/or reports on approved products designed to assist their representatives in recommending such products to clients. We feel that such guidance would be consistent with the dealer's obligations under the proposals. The obligation on representatives is incremental to their current obligations and is consistent with a meaningful and effective KYP review, but avoids the unintended and unworkable consequence triggered by the new proposed KYP obligations."

Thank you again for the opportunity to provide feedback to proposals in CSA Consultation Paper 33-404. We would be happy to provide further information upon request and answer any questions that you may have.

Sincerely,

Robert Parsons
Managing Director & COO
Arrow Capital Management Inc.

Mark Kennedy
Director, Legal & Compliance, CCO
Arrow Capital Management Inc.