October 12, 2018

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8

Re: Proposed Amendments to 31-103

Thank you for the opportunity to comment on the proposed amendments.

I have been employed in the securities industry for over 30 years as a Registered Representative, business conduct regulator (at the TSE, IDA and IIROC) and Chief Compliance Officer ("CCO") for Canadian and SEC/FINRA registered dealers. My first CCO position was in 1993. I have overseen nearly every aspect of investment dealer compliance systems at one time or another, from futures to investment banking.

I believe that the proposed amendments may have unintended consequences which will negatively impact investors, issuers, registrants and the Canadian economy. While it is not certain that the potential impacts described below will occur I hope that CSA staff will consider the possibilities raised in my comments. The changes that will be effected by the amendments are a radical change to an industry that, despite real problems, has served investors, issuers and the Canadian economy pretty well over the last hundred years. Our economy would not be the same without it.

In particular, a review of the impact on public (and private) companies and investment funds that are not approved by any registrant should be studied in more detail as the potential impact on those issuers and their shareholders could be catastrophic.

The amendments are not brief and I have done my best to review them in their entirety, but it is still possible (or even likely) that I have missed some wording that would affect the substance of my comments as set out below. To the extent that has occurred, some of my comments may not be as complete as I might wish. Since I do not have unlimited time, I am submitting these "as is" (typo's included) and hope the CSA staff will consider some of the potential issues I have raised.

I am making this submission solely on my own behalf. My comments do not represent the views of my employer or any other person or industry association.

Regards,

David C.C. Lister

Toronto

Prior Approval of all Securities

The requirement to Approve and perform due diligence on any security before it can be sold sounds like a good thing. On the face of it, it appears to make sense: you should know what you are selling. The approval and monitoring requirement will create very large costs to registrants (and ultimately, their clients), limit the ability of investors to sell their securities and negatively impact issuers and their shareholders whose securities are not approved by any registrant.

The language of section 13.2.1. reads: *"(1) A registered firm must not make a security available to clients unless the firm takes reasonable steps..."* to understand the security, approve the security to be made available, and monitor and re-assess the security.

The CP indicates it is CSA Staff's view that a security is "made available" to clients by a registered firm if it purchases <u>or</u> sells it for a client.

This means that no security can be purchased <u>or</u> sold by any client of a registrant until the registrant has approved it (more on this later).

The on-going monitoring will be even more onerous than the initial approval. The CP that sets out the expectations of CSA staff under the heading "Monitoring" (page 186)

> *A firm's KYP process must include a process for monitoring and reassessing securities that have been approved by the firm and continue to be made available to clients, to confirm that they remain appropriate over time. In addition, firms are expected to maintain reasonably up to date analyses of securities held in their client accounts even if they no longer continue to make those securities available to clients.*

The requirement to maintain an up to date analysis of all securities held in client accounts will be very expensive and perhaps impossible. A large dealer's client's will collectively hold thousands of different securities, not all of which are reporting issuers in Canada. It will be beyond the capability of most registrants to undertake such analysis, if it can be done at all. Why it is necessary to maintain an up to date analysis of a security that cannot be purchased or sold is unclear.

The natural result is that dealers will be forced to attempt to limit the number of different securities their clients are allowed to hold. This puts the registrant in a true conundrum: it cannot sell securities it does not wish their clients to hold until they are approved, but they may not want to approve the security, especially if they don't deal in that particular type of security. The only way to achieve this is to sell the securities before the amendments come into effect or pressure clients to deliver them to another registrant. None of these choices is very client-friendly.

The CP also reads:

> *We expect that this monitoring and reassessment will include an assessment of the continued competitiveness of the securities that a firm makes available to clients, as compared to similar securities available in the market (whether or not the firm has made such similar securities available to clients).*

The requirement includes comparing the security with all similar securities. This will require any registrant to acquire sufficient data on many thousands of securities just to make a basic comparison. The "security master" database in use by investment dealer firms lists over 150,000 securities with a current price. How will any registrant be able to compare such a massive number of very diverse securities and what will this cost?

The Companion Policy (the "CP") is clear that a registrant cannot rely solely on the documents provided by the issuer in completing it's due diligence. For many securities, there may not be information available from any other source. Relying on company disclosure documents such as the prospectus and subsequent public disclosures will not be sufficient. This will add to the time and cost required for approving a security. It may result in some securities not being approved at all since the due diligence required under the CP cannot be performed.

The due diligence required before a security can be approved will be even more difficult and expensive to apply to securities where the company is domiciled outside Canada. In some cases, it might be prohibitively expensive or impossible.

The time required to complete the due diligence and approve a security will also have adverse consequences. Currently, when a new issue is available it goes out 'by wire' (email) from the syndicate to a group of registrants. An individual registrant has a very short window of opportunity to determine if her clients are interested and request an allotment of shares. This window can be minutes or hours, not days or weeks. Few registrants will have the ability to approve a security fast enough to request an allocation. If the security is not already on the registrant's approved list, their clients will not be able to buy the new issue.

This will further limit investor choices and make capital raising more difficult since the pool of potential investors will be smaller. The smaller the registrant, the greater the negative impact will be. The smaller registrant firm's and their client's may be excluded from the new issue market almost entirely.

All registrants will be limited by time constraints in other ways. If a public company makes a favourable announcement and the price begins to rise, clients of any registrant who has not already approved the security cannot purchase the stock. This will be an incentive for clients to move their accounts to larger registrants who may (a) approve more securities and (b) do it faster. Clients with accounts at registrants with greater resources may have a significant advantage over those at smaller registrants.

Expectations Gap

The notice suggests that a major problem in the industry that is prompting the amendments is that “clients often have misplaced reliance on or trust in their registrants”. When clients learn that the registrant now has a list of securities that is has “approved” the level of trust will likely increase. It would be a natural reaction to consider securities that have been “approved” to be better than those other ones not worthy of approval. This could easily lead investors into believing the securities they purchase are safer than they really are.

Business Model not widely Adopted

The requirement for the registrant to approve all securities for sale and have a “shelf” of products for sale is not a new idea. It has been around for decades. It has been employed by at least one Canadian investment dealer (an affiliate of a US firm). This model has not been adopted by a significant portion of the industry. Clients are not abandoning the independent advisers. There is nothing in the pre-amble to the amendments to indicate any study of this existing model has been undertaken.

The amendments will force a business model on an entire industry that has met with limited success and limited acceptance by the public.

The Best Interest standard is over-arching

The comments to the amendments indicate that an “overarching” best interest standard was not adopted and the standard applies only when accepting an order (e.g. doing a trade) for a client, regardless of the circumstances of the trade.

This does not recognise that the primary activity at all registrants: trading. Trading is all we do. Everything else we do is in support of that activity.

The CSA notice indicates the best interest standard is limited to trading. This, by itself, effectively creates an over-arching fiduciary standard. It also does not consider section 13.3 which does create a true over-arching best interest standard.

Section 13.3 ‘Suitability Determination’ goes far beyond any current requirements. It requires a registrant to determine whether it is in the client’s best interest to <u>open an account at all</u> or take any ‘investment action’, not just whether the client’s intended activities are suitable. This determination is based on the Know Your Client information collected and *“any other factor that is relevant to the circumstance”*.

This requirement will result in some individuals being prevented from investing. What circumstances should lead a registrant to refuse an account is unknown. Should a potential client who has a mortgage or other debt be allowed to invest? Is it not in their best interest to pay down their debt and invest afterwards? If so, many Canadians will be prevented from investing.

As noted elsewhere, once the amendments are in force, it may not be in the best interests of anyone to invest Canada. As a Chief Compliance Officer and Supervisor it may become a regulatory obligation to refuse any account unless the client is prepared and able to lose their entire investment with no impact on their finances.

In whose best interest is it to buy a Penny Stock?

An important question is how will the fiduciary best interest standard affect the purchasing of securities in Canada?

Let us look at the speculative securities, the notorious “penny stock”. High risk tech start-ups and junior mining exploration companies are the classic examples. Purchasing a high risk start-up can be an “all or nothing” proposition. If the company succeeds, their securities may have some value, if not, they may become worthless. The question is: “Is it in anyone’s best interest to buy a penny stock?” When a penny stock declines or becomes worthless, a registrant will be challenged to prove the purchase was in the client’s best interest.

To protect themselves against this potential liability many registrants will be reluctant to approve penny stocks. No Chief Compliance (or Chief Risk) Officer is going to be in favour of approving them. The small registrants who depend on the penny stock business will have no choice but to approve some of them and take on the risk and costs that will accompany that decision, other registrants may adopt a policy of refusing to approve any penny stock.

Without the smaller registrants dealing in penny stocks there might not be a cannabis industry in Canada (or not as big, or as quickly). There would probably be no diamond mines in Canada. Voisey’s Bay, one of the world’s largest nickel mines would remain undiscovered. Who in their right mind would approve for sale securities of a company looking for diamonds in Labrador?

Alternatives to Canadian Public Markets

Another likely outcome is that small Canadian companies will have to look south of the border for financing and trading. Many already do. The United States does not have either the proposed approval process or the fiduciary standard.

Another likely consequence of the increased restrictions on available investments will be to drive wealthier and sophisticated investors to private equity outside the registrant community or outside Canada. To the extent this happens, liquidity in exchange traded securities will decline. Only the wealthiest Canadians will have this choice.

Account Transfers/Labour Mobility

The amendments prevent a client from transferring their account to a new firm if the new firm has not done ‘approval equivalent’ due diligence on all the client’s holdings. This will make it difficult or impossible for clients to move their accounts. If you want to move your account to another firm, they will first have to get a list of the securities in the account. If only one lacks the minimum due diligence, no transfer is allowed. Or the client will be forced to sell some of their securities before they transfer or transfer them to an order execution only dealer. Firms

that can approve (and continue to monitor) the larger number of securities will have a clear competitive advantage.

If an individual registrant decides to work at another firm, it will be more difficult to persuade their clients to move their accounts to the new firm if it means they must sell some of their securities and/or open a second account at an order-execution only dealer before they can transfer their account. This will make it far more risky for Advisers to change employers as fewer clients may follow them to their new firm.

Systemic Concentration and Market Risk

Due to the costs and liability related to the approval and ongoing monitoring of securities and the impact of the best interest fiduciary standard, it is unlikely any registrant will (or be able to) approve and monitor a large number of securities. The more securities the firm approves the higher the chances of one of them declining in value, creating both regulatory and civil liability risk. The result will likely be that the majority of investors will be corralled into purchasing a smaller and smaller pool of available public companies or funds. This concentration of ownership will likely be in "blue chip" securities such as those in the TSX 60 index. In the event of a market correction, more investors will likely be trying to sell more of the same securities at the same time than ever before in Canadian history. The greater concentration of ownership driven by the proposed amendments could significantly increase volatility and magnify market corrections.

The Transition

It is unlikely that any registrant will approve all the securities currently available in Canada. It is almost certain that some securities will not be approved by any registrant. A critical question is: how many securities will be not be approved?
When this happens, the market value for the "un-approved" securities will likely collapse since the majority of investors will be prohibited from buying or selling them. Only investors at order-execution only registrants or portfolio managers or permitted clients will be allowed to buy or sell these un-approved securities. The average investor will be shut out.

When the amendments come into effect, all "un-approved" securities will likely decline in value (or have no market value at all). We may be faced with a two-tier marketplace, one where the public trades approved securities, and another where order execution only clients, PM's and institutions trade unapproved securities.

There might be a wide spread sell-off before the amendments are effective as investors try to align their portfolio's with securities they believe will be approved. It may be like the old game of "musical chairs", when the music stops, investors holding unapproved securities will be left without anything to sit on.

The New Inside Information

Knowing in advance which securities will be approved or non-approved will be valuable information. The smaller the number of approved securities overall, the more valuable this will be. Anyone with such information will be able to sell their soon-to-be "un-approved" securities before the public and avoid potential losses. Similarly, such knowledge will allow a person to purchase securities in advance of their approval and potentially make significant profits.
Which securities are approved by a registrant will not be public information. The registrant does not have to tell anybody which securities they have approved or whether they plan to take a security off their approved list. If a registrant planned to remove a security from its "shelf" of products, it could, quite legally, tell their advisers in advance who would tell their clients to sell before the other registrants and the public found out about the up-coming change.

Why TransCanada Corporation might no longer Exist

Let's apply the possible effects of the amendments to real events in the market. An example of what could happen is can be demonstrated by looking at TransCanada Pipelines in the 1990's. In the mid to late 1990's the company cut their dividend. The stock price dropped from around $20 to $13. Under the proposed regime, it is unlikely any registrant would be able to maintain the company on their approved list since it would no longer be "competitive" with other pipelines that had not cut their dividend and whose prospects were more certain. In fact, keeping it on their approved list might be a violation of securities law (or at least, breach the guidance in the CP) and expose the registrant to regulatory and civil liability. Once off the approved list, most investors would not be able to sell or buy the stock. This would likely result in a further drop in price (in addition to that due to the dividend cut). The decline in the price of the stock would force other registrants to remove the company from their approved lists. It's securities may all become "un-approved" by any registrant (including any preferred shares or debt). The company would not be able to raise money since the larger registrants who would normally act as underwriter could not purchase the shares for their clients. This could put further pressure on the company.
Only investors at an order execution only dealer and institutions/PM's would be able to trade the shares, but given the circumstances, why would they other than to take advantage of the companies plight?

The phrase "death spiral" comes to mind.

No Safety

The potential death spiral effect could make owning Canadian public company shares a much riskier proposition that it is today. I may become possible to suffer significant losses on any public company, no matter how "blue chip" they are. All that needs to happen to a company is a temporary set-back and getting dropped from the approved lists. This only has to happen a

few times before investors figure out that buying shares in any public company in Canada can be a risky affair.

Even if there was an exemption from approval for sales, once a security cannot be purchased by most investors, it's liquidity will suffer greatly.

Invest Outside Canada

Investors might also quickly realise that securities listed in other countries would not be subject to the potential 'Canadian death spiral' and choose to invest in securities listed outside of Canada. Wealthier and more sophisticated investors may move their entire portfolio to an offshore investment dealer or portfolio manager where they can invest without the restrictions placed on them in Canada. Average investors will not have this option.

International Investors

To the extent that the impact of any of the above concerns materialise, there will be a significant disincentive for any offshore investors to put their money into Canadian public companies. This could have significant negative impact on the entire economy.

The End of the Independent Adviser

The individual registrant will truly become a salesman again. Until now, at least in the investment dealer environment, the individual registrant had multiple roles. One of the most important, was to analyse the different securities available and decide what stocks, bonds, funds, etc. to recommend to their clients and perform an ongoing review of those holdings. For the most part, each adviser was free to adopt their own style of investing (individual stocks, mutual funds, ETF's, private placements, etc.). This will no longer per permitted.

Exemption for Client Directed Purchases

The proposed amendments have an exemption for Suitability for client directed trades if certain conditions are met. In addition, there should be an exemption from firm approval and individual registrant due diligence for a client-directed purchase which is not recommended by the registrant. Failure to do this will also add to the burden on clients who may occasionally pick a security to purchase on their own. If the security is not on the approved list the registrant cannot purchase it for the client. The client will be forced to open an account at another registrant who has approved the security (if they can find one) or at an order execution only registrant where they cannot receive advice. If they want to purchase the security in a registered plan account, this will mean additional fees.

Exemption for Sales

This section needs to be revised to be specific that an Adviser can sell any security held by a client regardless of whether it is approved by the firm or the Adviser's degree of knowledge regarding the security. To attach conditions to the purchase a security is one thing, but preventing the public from selling securities they already own is not, in my opinion, in the public interest.

A New Category of Registration is Necessary.

Since the proposed amendments eliminates the independent adviser a new category of registrant and individual registration is necessary to save our penny stock markets and make raising capital possible in Canada without a company being approved by the larger registrant firms. It should be named "Stock Broker" as a registrant category and "Salesman" for individual registrants. They would be exempt from nearly all the amendments. They would be subject to the same standards that built the securities industry and much of our economy in the last century. (e.g. follow your clients instructions and act within the bounds of good business practice, dealing honestly and in good faith with your customers and disclose conflicts).

They would be allowed to trade securities listed on an exchange or act as underwriter and sell private placements for public and private companies. No mutual funds, no fancy "structured products", nothing to confuse their business with the new business model being forced by the proposed amendments.

The new Stock Broker category would recognize that an individual Salesman has decided that a particular security may be a profitable investment. That decision might be made because they know the person running the company, or the new cannabis industry is going boom for a while. There has been no pre-approval of the security and you can lose your money. It is, after all, a stock market which has always been risky and unpredictable.