NSCP
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Financial and Consumer Affairs Authority of Saskatchewan
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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Delivered to:

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Dear Sirs/Mesdames:

Re: Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms) – Published for Comment June 21, 2018

Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Comments from The National Society of Compliance Professionals (NSCP)

NSCP is a non-profit, membership organization with approximately 2,000 members and is dedicated to serving and supporting compliance professionals in the financial services industry in both the U.S. and Canada. To our knowledge, NSCP is the largest organization of securities industry professionals in the U.S. and Canada devoted exclusively to compliance. In light of NSCP's focus on compliance and compliance professionals, our comments will be limited to concerns that impact compliance programs and/or compliance professionals.

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It is in this latter capacity that we are pleased to provide the various members of the Canadian Securities Administrators (**CSA**) with comments on the above-noted Client Focused Reforms. Our comments are those of the NSCP as a trade-industry lobby group and do not necessarily represent the views of all of its members; however, they are informed by the NSCP members who provided comments to NSCP.

We have close interactions with regulatory bodies in reaching outcomes for our members and the investors they service, with due regard to investor protection concerns. We consider that our member firms and their experiences gives us an informed view of the nature of the financial services industry in Canada today, as well as an expertise in registrant regulation and compliance that applies across multiple firms, multiple registration categories and multiple regulators.

All of our comments should be viewed with the understanding that NSCP has a strong appreciation of the role of the securities regulators and the challenges they face in achieving balanced investor protection while fostering fair and efficient capital markets.

It appears that much of the Client Focused Reforms appear to have been written with the smallest, most vulnerable and least sophisticated investor in mind. While we agree that these investors need to be protected (as do all investors) and we applaud the work the CSA has generally done in this area, we believe that the Client Focused Reforms (i) perhaps skew too much to the protection of these most vulnerable investors, and (ii) are not flexible enough to recognize the various platforms and client bases of differing registered firms in Canada.

There is a general concern in the compliance community that the suggested reforms as a whole will increase regulatory burden, administration, disclosure, costs and business and regulatory risk to registered firms. This has the propensity to result in increased costs for those very same small and vulnerable investors, but also may result 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 also fear that this increased regulatory burden will cause firms to look very closely at the regulatory risk of all aspects of their offerings and reduce their offerings to those that most easily 'facilitate' or 'fit within' the new rules. As regulators become more and more prescriptive with rules, firms will start to tailor their offerings to more easily apply the rules and reduce risk of inadvertent violations of the rules.

Our specific comments on certain of the Client Focused Reforms are as follows.

Targeted Reform – Conflicts of Interest

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

   (a) The term "conflict of interest" is a very broad and undefined concept. In our experience, it is very difficult to explain conflicts of interest in a conceptual way – much less identify

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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 this concept, so that a better understanding of what is intended by the Client Focused Reforms may be had. We know that international regulators have defined conflicts of interest – and that the term is defined in National Instrument 81-107. It is highly unclear as to the CSA's concerns about conflicts of interest, beyond "compensation related conflicts" and the distribution of "proprietary products", which conflicts are easily resolved through clear and concise disclosure.

(b) We note that the guidance in the CP suggests that each firm define what constitutes a "conflict of interest" by developing "a working description of conflicts of interest that enables the registered firm, and each individual acting on its behalf, to understand and identify conflicts of interest that may arise". 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.

2. Proposed subsection 13.4.2(2) indicates that a "registered firm must avoid any conflict of interest between the firm, including each individual acting on its behalf, and a client if the conflict is not, or cannot be, addressed in the best interest of the client". This appears to be unworkable when examined. For example, one obvious conflict between a client and a firm is the fee that a registered firm charges for its services – such a conflict can arguably never be addressed in the best interest of the client. Arguably the fee would have to be zero to be addressed in the best interest of the client. This is only one of many examples where this test is or may prove impossible to apply. In our view, the "test" needs to be revised to something that reflects past consideration of this issue. For example in *In the Matter of Crown Hill Capital Corporation and Wayne Lawrence Pushka*, it is noted at paragraph 112 that "[a]ccordingly, an IFM's fiduciary duty under section 116 of the Act requires that the IFM….generally avoid material conflicts of interests and transactions that give rise to material conflicts of interest on the part of the IFM, including self-interest and related party transactions." Similarly, at page 53 of OSC Staff Notice 33-749 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, it is noted that registered firms should "avoid the situation giving rise to a conflict of interest <u>if the risk of harming a client or potential harm to the integrity of the markets is too high</u>". We support the concept of materiality in assessing whether a conflict must be avoided. We submit that to move from a materiality test as set forth in past OSC guidance and decisions to one which is based on the best interest of the client is unworkable and not appropriate based on past and established guidance on fiduciary obligations.

3. Including those conflicts that are "reasonably foreseeable" is too broad to be practically implemented and this would make it incredibly burdensome for every firm to put in place a procedure that requires all possible potential conflicts to be disclosed and/or avoided. This would

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increase the costs of compliance for registered firms, without any concrete (and certainly not commensurate) benefit to the client.

4. The proposed provisions on avoiding conflicts with respect to 'proprietary products' is concerning. We are unclear how a firm could control this conflict "in the best interests of clients", such that it should not be avoided (even given the examples of controls provided). Are the sample controls provided mandatory (or will they end up being seen as such on compliance audits)?

5. Proposed section 13.4.3 requires that a registered individual must not engage in any dealing or advising activity in connection with a conflict of interest unless the registered individual's sponsoring firm has given the registered individual its consent to proceed with this activity. In many (if not most) cases, conflicts of interest situations are addressed in a firm's policies and procedures. Given this, and given the logistical issues of a registered individual seeking specific consent for each such action, we would recommend that clause 3(b) of this section be revised to "the registered individual's activity is made in accordance with the policies and procedures of the individual's sponsoring firm with respect to such conflict of interest or the registered individual's sponsoring firm has given the registered individual its consent to proceed with the activity".

Targeted Reform – Know-Your-Client

6. We are concerned that the existing blurring of the lines amongst registration categories that exists today will become even more pronounced if the Client Focused Reforms come into force. The client relationships of dealers with their clients are much different from the relationships of advisers with their clients – and we believe that the "one-size fits all" approach suggested in the Client Focused Reforms does not properly account for these differences.

7. 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. However, we have a concern that the guidance in Annex C 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. This is not a reasonable expectation and reflects an 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 are concerned about an unintended consequence that firms and advisers will limit the types of clients – and asset levels – they are willing to work with (that is, rejecting the smaller investors who may most need assistance from a registrant).

8. The suggestion that registrants should "take into account whether there are any other priorities, such as paying down high interest debt or directing cash into a savings account, that are more likely to achieve the client's investment objectives and financial goals than a transaction in

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securities" is problematic. Generally, many 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. This is really forcing a registrant into the realm of "financial planning" and it is not appropriate to include a financial planning obligation on a registered firm or their registered individuals.

9. 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 maximum permitted in registered tax plans (RSPs, TFSA and RESPs). Some investors only wish for an advisor to invest a portion of their assets in accordance with their instructions and do not want to divulge their entire detailed financial information to that advisor. There is no reason why such investors should not be entitled to make this choice for themselves. In addition, we consider it essential that, should the Client Focused Reforms come into force as drafted, the CSA embark on an investor education plan to inform investors about the additional information that registrants will be required to obtain from investors and explain to investors the need of registrants to ask for such information.

10. The technology and other compliance costs with implementing these changes to KYC could be large for bigger forms. For example, many firms use Salesforce to track KYC information of their clients. The setup costs for Salesforce can be between $300,000 to $600,000 depending on the services needed.

Targeted Reform – Know-Your-Product

11. We do not disagree with the concept that a representative must understand what he or she is recommending to their client. We are concerned that the supersizing of the existing requirements as contemplated in the Client Focused Reforms are costly and burdensome to implement from a compliance perspective and will have unintended consequences. We question the utility and realism of the expectations that representatives have in-depth understanding in the ways articulated in Annex C of each security on the firm's shelf – and "how the products compare to one another". 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 can be met. For example, an adviser that offers in-house managed funds as a way to deliver advice efficiently to its clients should not have to go out in the marketplace and assess all similarly-priced products and offer a competitive price. Perhaps they think that their brand and service is worth more than their so-called competitors and if so, they should be able to charge what they feel it is worth. In such cases their client knows they are only getting access to that adviser and its products – indeed that may be the very reason that they have gone to that adviser.

12. The proposed concept of comparing products against "similar securities available in the market" is problematic. We raise the following examples:

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(a) Some firms do not sell a single fund but a basket of funds which makes comparison difficult.

(b) The level of servicing is different across registered firms, so fees would be difficult to compare.

(c) Various firms have different investment styles and products at "similar" firms (in terms of firm investment style) may not correspond to the products at the registered firm. For example, how could one compare emerging market funds that are so drastically different from one another (as there are so many countries in the "emerging market")?

(d) Comparing funds with different market caps or other restrictions can be difficult.

(e) It would be extremely difficult and subjective to compare any product to the market because no firm is going to know its competitor's products to the same level of detail as its own products – and no competitor is going to give another firm the information necessary to conduct a direct comparison. Even if such were to happen, this would decrease competition and product availability in the marketplace.

(f) Does a firm that sells Canadian equity mutual funds have to understand and compare all "Canadian equity" mutual funds in Canada before making a purchase recommendation in such security?

(g) How does a firm discharge this obligation for certain types of private illiquid securities? Is the firm able to simply determine that there no "similar securities" to this product and end the analysis there?

(h) The policy would also have to define how often this comparison would have to be done, considering the market changes and one product could do better than another product one quarter then vice versa the next.

(i) Initial and ongoing compliance costs to implement and monitor these requirements could be prohibitive. There are some technologies that can be used to assist in these comparisons, but they are expensive. A sample is below:

(i) eVestment costs approximately $50,000 per year

(ii) MPower costs between approximately $250,000 to $500,000 per year

(iii) Bloomberg costs approximately $1 million per year

(iv) Charles River costs approximately $600,000 per year

13. The concept of a "reasonable range" of alternatives as contemplated in the proposed Companion Policy is also very subjective and difficult to administer, especially when comparing products or funds. For example, every registered firm has its own way of valuing

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a security for inclusion in a specific type of product or fund (for example, with respect to investment philosophy – one cannot compare a quantitative analysis fund with a fundamental analysis fund or a technical analysis fund, even if they are all designed as "Canadian equity" funds). We would suggest that what constitutes a "reasonable range" of alternatives should be left up to each registered firm and its professional judgement, based on what the firm's respective business model dictates, as long as such policy was developed reasonably and supported by documentation. As such, the concept of a "reasonable range" should either be deleted from the Client Focused Reforms or guidance be provided for firms to implement an appropriate set of parameters for themselves

14. We would also consider it appropriate that certain securities be subject to a simpler and less onerous KYP process (including, for example, conventional mutual funds, which are highly regulated in terms of disclosure and material facts).

Targeted Reform – Suitability

15. While we are fine with the requirements that a registered firm should do a reassessment of suitability (presumably with the client) if there are material changes in the client's KYC, we are unsure around the requirements to take reasonable steps to obtain a client's confirmation of the accuracy of the information collected, "including any significant changes to the information". Would sending a letter once a year asking a client to review and confirm the KYC be sufficient in these circumstances?

16. We also have concerns with the concept that would require a registered firm to inquire about the client's other investments or holdings held elsewhere in order to inform its suitability determination. If a client refuses to provide this information (for example, for privacy reasons), will the firm be at fault for not collecting the data? Is simply *inquiring* sufficient with a notation in the file that the client refused to provide the information?

Targeted Reform – Training

17. While we are generally supportive with the proposed training requirements, the type and breadth of the training should be tailored to the nature and size of the firm. For example, training could be online training, outside speakers, case studies, discussion group, roundtable or conferences, some of which would or may not be "written". This would also allow firms to allocate their own budget on training needs. For some smaller firms, an annual or semi-annual, firm-wide single comprehensive session for all staff may be sufficient. But other firms may wish to conduct a series of smaller sessions on discrete topics throughout the year, each covering off a different aspect of the training and tailored to different personnel.

18. And "training" often takes place in registered firms outside of formal sessions and we urge the CSA to recognize this. It is common industry practice for research analysts or investor relations people to have weekly business line- or product-focused meetings. Would these meetings qualify as appropriate "training" (particularly where they involve KYP?

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19. One aspect of the prosed training requirements is particularly concerning for us as compliance professionals and that is that, no training, no matter how well designed and implemented, can possibly "ensure that everyone at the firm … acts with integrity when dealing with clients" (as set out in the second sentence under the heading "compliance training"). We recommend amending the words of this guidance to "seek to ensure".

Targeted Reform – Referral Arrangements

20. We do not agree with the changes to the referral arrangements provisions, especially to the restrictions concerning (i) banning paid referrals from non-registrants, (ii) period of time and (iii) a cap on fees. We do not see how these limits would "cure" the issues raised by the CSA. We would submit that the vast majority of referral arrangements work and function perfectly within the law as currently drafted and to the benefit of investors, who often receive a more integrated financial "experience" from the parties involved. Imposing restrictions on this otherwise workable rule to prevent one or two "bad apples" from operating seems unnecessarily heavy-handed.

21. We also worry that these restrictions could shut down very viable and proper sources of client business for smaller firms. Non-securities related service providers (accountants, lawyers, financial planner, insurance agents) often refer their clients to registrants. A prohibition against referrals between non-registrants and registrants appears to defeat the purpose of having referral arrangements – referrals arrangements between registrants are less common, as many registrants have the ability to cross-service more than one type of relationship (for example, many IIROC dealers are able to offer discretionary portfolio management; PMs may also be registered as EMDs). The prohibition may also unfairly favour large, integrated firms (financial institutions with insurance, mortgage, banking verticals in addition to securities business) at the expense of smaller independents.

22. Conversely, given that compensation often drives behaviour, imposing a 3 year time limit on referral arrangements may incent a referral agent to churn their contacts to new managers every 3 years, which would obviously not be in the best interests of the client. A possible effect of this time limit is that, if a referral agent is only going to be paid for 3 years, they may be less inclined to ensure that they are referring to registrants that will manage the investment for the client well over the long term. In fact, such referring agents may be possibly happier if the client is satisfied only for the short term and then agrees to move. Most registrants are looking to establish long term relationships with clients and, we would submit, are looking to set referral arrangement terms that incent the referral agent to be looking to place their contacts into long term relationships with such registrants.

Targeted Reform – "Publicly Available" Information

23. While we generally support the concept that prospective clients of a firm should be well informed about the firm's products, services, fees and business prior to becoming a client, we do not believe that a firm should be required to make certain information "publicly available" on its website. We highlight the below potential issues:

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(a) Some firms have sliding fee scales and/or lower fees for household/multiple accounts.

(b) Firms may have different fees for separately managed accounts than for pooled funds and the firm will not necessarily know in which type of account the client will be investing at the onset.

(c) Some firms have a fee scale on some performance fees (for example may not charge performance fees over a certain period of time or until a certain threshold is met).

(d) Firms may have different fees for different sets of clients (private client, wealth management clients, retail investors, institutional investors, etc.) that they may not wish to divulge to clients not within the particular group.

(e) Firms may not offer all products or all similar products to all clients.

(f) There may be issues for firms that are dually registered with the SEC. Some firms would be caught under the general solicitation Rule 506 of Regulation D if they displayed information on the firm's funds. Many firms avoid this by showing strategies, but not fund-specific information (https://www.sec.gov/fast-answers/answers-rule506htm.html)

(g) Some firms purposely do not have a website or have solely a splash page/skeleton website. To hire someone to put together a website to comply with these rules could cost approximately $250,000 to 350,000 for the design and build of a compliant website. Some of NSCP's member firms have advised that to add additional pages to their website to comply with these proposed requirements would cost approximately $50,000 to 100,000 to set up and then ongoing yearly costs of an additional person to maintain the website with this new information.

The above issues may all increase confusion for prospective clients, which may result in an expectation gap once the client meets with the firm (i.e. they may have misunderstood the particular products/services/fees applicable to them and may feel misled once in an onboarding meeting). Providing such detailed information about a firm to a prospective client is best reserved for initial and/or onboarding meetings with such investors where the conversation can be tailored to the particular products, fees and offerings that are available to that client.

While a firm may wish to provide a myriad of information to prospective clients on its website, it should not be mandated to do so.

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We thank the CSA for giving us this opportunity to present our views on the Client Focused Reforms. NSCP would welcome the opportunity to answer any follow-up questions that the CSA may have regarding this submission or to provide such further assistance as the CSA may request.

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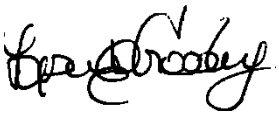
Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at 860-672-043.



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