Federation of Mutual Fund Dealers
Fédération des courtiers en fonds mutuels

October 19th, 2018 VIA E-MAIL ONLY

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

Attention:

The Secretary
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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Dear Sirs and Mesdames:

RE: Client Focused Reforms – Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103 CP

The Federation of Mutual Fund Dealers (the "Federation") has been, since 1996, Canada's only dedicated voice of mutual fund dealers. We currently represent dealer firms with over $124 billion of assets under administration and 18 thousand licensed advisors that provide financial services to over 3.8 million Canadians and their families and as such we have a keen interest in all that impacts the dealer community, its advisors and their clients.

The Federation is pleased to provide comments on the captioned Proposals.

3.4.1 Firm's Obligation to Provide Training

The Proposals create an explicit obligation on a registered firm to provide training to its registered individuals on prescribed elements of each product on the firm's product shelf.

Registered firms should be able to take a flexible approach to product training. Investment funds are already subject to comprehensive, standardized disclosure

obligations. The CSA have expended great effort in ensuring that fund information, not the least of which fees, is clear and comparable across funds. The registered firm should be able to direct its registered individuals to these disclosure documents and their source as the authority on information about the fund. Registered individuals can use the fund prospectus, together with the Fund Facts document or ETF Facts, to understand the structure, features, returns, risks and costs of a fund and to compare funds. Any suggestion to the contrary could result in inconsistent disclosure, potential errors, lack of comparability among funds and could undermine the CSA's efforts to create specific and comparable information on funds.

Note that National Instrument 81-105 Mutual Fund Sales Practices specifically recognizes the role of investment fund managers in the registrant education process and sets out acceptable educational practices. We believe this practice can continue to assist distribution firms to meet their product training obligations.

We would ask that the CSA include that registered firms can fulfill the know your product training obligations by the review of the disclosure documents available from the product manufacturers.

13.2 Know your Client

One interesting occurrence is the reluctance of some clients to provide the kind of detail required by regulation. This could be because of general distrust of anyone with that much important information, it could be culture or other reasons known only to them. This is a situation beyond the registrant's control.

We would recommend that the CSA acknowledge these circumstances and provide guidance as to the remedy(ies) registrants have available to them to comply with the requirements of the CP.

The CP introduces new obligations not set out in the Instrument. The client liquid needs assessment will require registrants to complete a detailed cashflow analysis and document a client's short and long-term income and expense, planned major expenditures and reserves set aside for potential job loss or disability. The CP also introduces a requirement to determine a client's overall financial needs in addition to the current requirement to determine the client's investment needs, also requiring a detailed cashflow analysis. We believe these obligations to be a waste of the client's time and patience if it not applicable to them. Done in a fulsome way these should sit within the financial plan realm. Should a client be requesting a financial plan, then these might be appropriate.

The comments also introduce an expectation that registrants will provide clients with an estimated investment return necessary to meet the client's financial goals. We suggest that the CSA amend this to reflect that this expectation should be limited to investments held through the registrant, accompanied (if deemed necessary by the financial planner) by the client's commitment to the plan which would include funding/contributions and limiting withdrawals.

13.2.1 Know your Product

In October of 2005 the Mutual Fund Dealers Association issued Staff Notice 0048 Know Your Product. We can say with confidence that as a result, we saw mutual fund advisors moving client assets to segregated funds and some gave up their mutual funds registration. We also saw mutual fund dealers reducing the number of products they made available for sale by their advisors.

We believe that some of the Proposals will trigger a similar but more pronounced reaction. And with the sheer volume of mutual fund product availability alone, it would be virtually impossible for a dealer to demonstrate that they had performed in-depth due diligence of each, to determine what to put on their shelf. In Canada at October 3rd, 2018 there were[1]:

- 482 fund companies
- 41,707 total funds and clones
- 22,352 distinct funds, and
- 2,318 fund managers

We have no doubt that dealers will be forced to narrow their product shelves so that they and their advisors can successfully perform their compliance obligations. While this could be a positive if the focus is on the most suitable and strongest investment options, we are concerned that product shelves would become overly restricted. This in turn reduces the choice for investors. We don't believe this is the intent of the Proposals.

We disagree with the requirements under s.13.2.1(6). A mutual fund dealer should be allowed to transfer in a security so long as they are licensed to trade it. After the transfer completes, they should then be allowed time to perform their due diligence and be obligated to act accordingly on their findings.

We believe that the know your product obligations for investments transferred in or purchases through client-directed trades will result in clients being unable to consolidate assets with a registrant of their choice, missing opportunities for any available fee reductions from tiered pricing or being limited to order execution only firms for those investments. This may be particularly problematic for aging clients seeking to consolidate their assets to follow a professional financial plan.

We request that the CSA reconsider those aspects of the Proposals that may have the unintended consequence of reducing investor choice and Guidance in this area should be aligned with existing guidance from the self-regulatory organizations (SRO).

"Dealer members are entitled to rely on factual information and disclosure documents provided by issuers or manufacturers of products under review, unless there are obvious reasons to question their validity. However, in doing so the dealer member will have to judge whether the disclosure document answers all the relevant questions and whether it provides enough, balanced disclosure or is overly promotional in nature."

[1]Per the Fund Library http://www.fundlibrary.com/funds/db.asp

This approach allows firms to exercise their professional judgment to determine when further inquiry is necessary based on the information provided by an issuer. This is also consistent with the approach in MFDA Staff Notice MSN-0048 Know Your Product that sets out a process that begins with an independent and objective assessment of the issuer's offering documents and marketing materials.

We would ask the CSA to amend the Proposals to explicitly support a risk-based product due diligence approach. Conventional mutual funds and exchange-traded funds should require less in-depth inquiry, with greater reliance on the CSA mandated disclosures contained within issuer documents.

13.3 Suitability Determination

The Instrument requires registrants to conduct a suitability determination *before a registrant acts by opening an account for a client, purchasing, selling, depositing, exchanging or transferring securities for a client's account, taking any other investment action for a client or making a recommendation or decision to take any such action…*

We recommend that this requirement be amended to align with the existing MFDA requirements for the transfer of assets whereby the suitability assessment must be performed within a reasonable time, but in any event no later than the time of the next trade.

We agree with a portfolio approach to suitability and believe that it is appropriate, however, guidance should go further to acknowledge that if holdings in one account are 100% in one investment, it does not mean that it is unsuitable from a portfolio perspective. All information that has been gathered relating to the client should be taken into consideration and weighed.

While the 31-103 CP provides extensive guidance on specific suitability factors, there is a lack of guidance with respect to the *client first* element of the suitability determination and how registrants demonstrate compliance. We would ask the CSA to acknowledge that when a registrant meets its suitability and conflicts requirements it has been deemed to have put the client's interests first.

13.4 Conflicts of Interest

As we said in our submission dated October 2016, *we don't believe that there is **any** value in adding a new requirement to specifically list these incentives to clients. The industry adopted sales practices best practices in the early 1990s which later were codified in NI 81-105. That Instrument is very specific in its application to restricting the solicitation of payments, the provision of benefits, the practices of dealers and distributors, cooperative marketing, conferences and so on. The industry has had twenty years to amend their policies and adopt practices including supervision and audit in compliance of this Instrument; and regulators have had as long to monitor this behavior.*

In addition, we do not believe that the text you are suggesting adding to the report on fees and charges is necessary, nor is it accurate:

"In addition to the payments specified in this report, [the firm] or its representatives may also receive other sales incentives related to the securities that you have purchased through us. These incentives can influence representatives to recommend one investment over another".

The purpose of NI 81-105 was to make any kind of non-cash incentives so de minimis to eliminate any conflict of interest and we believe that the Instrument has been successful in this. For dealers and representatives who do not avail themselves of non-cash incentives it would not be accurate, and for those who do but adhere to NI 81-105 it would not be true.

Therefore, we would ask the CSA to acknowledge that NI 81-105 regulates the activity of registrants in the context of mutual fund sales practices.

The CSA should not require additional steps to mitigate the material conflict if there is no material incentive. Conflicts that are not material, are consistent with the guidance in the CP, can be addressed through the existing policies and procedures or codes of conduct that guide registrant behaviour. We also agree that disclosure of conflicts must be provided in plain language that is easily understood by investors.

Further, we would recommend you avoid overly legalistic language, duplicative disclosure, and harmonize the terms you use throughout the Proposed Policy and Companion Policy.

We agree that a registrant must identify and address all conflicts of interest in the best interest of clients. We would recommend however, that s.13.4.5(1) should be amended to include the word "material". Material conflicts are of concern, and information about them is of value. This would be consistent with the approach taken by the CSA in NI 81-107 *Independent Review Committee for Investment Funds*. The CSA applied a "reasonable person" test to define an example of a conflict of interest and explained in the related commentary that the CSA do not expect this "to capture inconsequential matters".

We would agree with other commenters in suggesting that the CSA incorporate guidance to the effect that registrants address conflicts in a fair, equitable and transparent manner through the exercise of responsible business judgment.

We recommend the CSA amend section 13.4.5(1) to require disclosure of material conflicts of interest of which a reasonable client would expect to be informed. We also request the CSA incorporate guidance that registrants should address conflicts in a fair, equitable and transparent manner through the exercise of responsible business judgment.

The Proposals state that *disclosure is not enough to satisfy the obligation to address conflicts of interest in the best interest of the client*. This provision would set a higher duty on registrants in managing conflicts of interest than is expected of a fiduciary at common law. Consider as well, that disclosure as an effective mitigant in the appropriate circumstances is consistent with the approach adopted in other areas of the Instrument. We would ask that the CSA amend the Proposals and CP to state explicitly that disclosure can be an effective mitigant in some circumstances.

13.6 Referral Arrangements

Section 13.8(1) imposes a new restriction on referral arrangements that prohibits registrants from paying fees to non-registrant firms. We agree with this with one exception; should an advisor refer a client to another profession and by that we mean a lawyer or and accountant for example and receive a one-time referral fee from the professional, we do not take issue with that. The advisor makes the referral to assist the client, it is *client motivated*.

We are concerned however about the contraction of the mutual fund dealer channel of distribution where for example, you have dual licensed individuals abandoning their securities registration and through their insurance license receiving ongoing referral fees from portfolio managers for having transferred their book of business. This is where we have non-registrants collecting the bulk of the revenue from registrable activities. The Proposal says *Much depends on motivation for the payment and acceptance of the referral.* This is a business decision for the registrant, this is not client motivated.

We believe further consultation is warranted in this area and we would be very interested in participating.

14.2 Relationship Disclosure Information

An approach that recognizes that disclosure is an effective mitigant in the appropriate circumstances is consistent with the approach adopted in other areas of the Instrument. As such, we would ask the CSA to amend the Proposals to state explicitly that disclosure can be an effective mitigant in some circumstances.

Other Considerations:

Cost-Benefit Analysis

As we have noted in past submissions, the Proposals were not accompanied by a cost-benefit analysis. You acknowledge that the compliance costs to registrants will be significant in many cases, but you have not defined 'significant'.

You also acknowledge that clients will bear some of these costs, *"We anticipate that the one-time and on-going costs likely to be imposed by the proposed amendments will be borne directly by registrants, indirectly by their service providers and, to a certain extent, passed on to clients."*

We would argue that the investing public, like anyone else purchasing a product or service in any industry, will eventually pay for all the costs to bring that product or service to them.

Best Interest

The fact that a recommendation or decision is determined by the registrant, on a reasonable basis, to be suitable for a client … will therefore not be considered to be enough to meet this obligation; the registrant must also determine that the action puts the client's interests first ….

Proposed Amendments are client focused reforms that put the interest of the client before any other consideration relevant to the client registrant relationship. The combination of the codification of best practices and the introduction of new requirements will result in a new, higher standard of conduct for all registrants.

*They must put the client's interests first, whether in terms of remuneration, financial gains or other incentives, and exercise their professional judgement in a client-centric manner when opting for one decision or recommendation among other suitable possibilities, if any. For example, maintaining inappropriate amounts of cash in the client's account, or leaving cash in the account uninvested for unduly long periods of time would not meet the requirement of putting the client's interest first. **

* We disagree with the inclusion of the examples provided. The determination of whether this is part of a suitable strategy, and this may be, would be made by the advisor and the client with the dealer's supervision.

This Companion Policy Sets out how the Canadian Securities Administrators interpret or apply [emphasis added] *the provisions of National Instrument 31-103.* We believe that in practice you will expect adherence to the guidance you have provided, not just with respect to Best Interest, but in several other areas including know your product and internal compensation arrangements and incentive practices. We would ask that you incorporate into NI 31-103 any aspects of the Companion Policy that are regulatory requirements.

Transition Timeline

The CSA Notice suggests an immediate implementation for referral arrangements (other than pre-existing arrangements which must be brought into conformity in three years), one year to provide publicly available information and two years for all other new requirements, including know your client, know your product, suitability and conflicts of interests.

We would ask the CSA to provide one transition timeline of three years beginning from the publication of the final rules for all aspect of the Proposals.

Unintended Consequences

For investors these may include less product available through their existing or prospective dealers and significantly higher costs for receiving investment advice. This will, in turn, result in many more investors foregoing investment advice and becoming DIY (do it yourself) investors even though this may be a poor choice for many given their investment knowledge and/or personal circumstances.

As the CSA stated, the implementation costs of the Proposals will be significant for the industry. The nature of the costs and requirements will differ based on the business model and size. A disproportionate impact will be felt by smaller firms and may result in reducing competition and investor choice if they exit the market or a segment of the market. As a result, it is imperative to make the implementation costs more manageable through certain critical changes and clarifications to the Proposals.

Lower Costs = Better Investment Outcomes

The premise appears to be that better investment outcomes for clients can be achieved only through lower cost products and services and we are concerned that the overemphasis on costs does not give value to the advice clients receive and may have the unintended outcome of reducing investor choice.

We do not agree that costs should be the primary consideration. 13.3 says *unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1). However, we recognize that there may be reasons why a specific higher cost security available at the firm may be better for a client than other suitable securities available at the firm.*

The goal of most investors is to build wealth over time with a portfolio that delivers favourable returns and that is consistent with their risk profiles and financial objectives. However, implicit in the Proposals is that client outcomes are not defined as long-term savings or wealth accumulation but are rather associated with the cost of investment products. While we agree that costs affect client returns, we do not agree that suitability is fulfilled by a selection of solely the lowest-cost products. Professional advice and active management are both critical components of successful client outcomes.

Such language creates ambiguity about how a registrant should consider costs and may cause registrants, due to regulatory concerns, to avoid recommending products that may be suitable for a client but have higher costs. Products that are not the lowest cost may offer other benefits, such as the nature and quality of the product provider's services (including the advantage to the client of consolidating investments at a single product provider to obtain fee discounts or other services that may be offered), minimum initial investments, ease of doing business, skill of the portfolio manager(s), the reputation of the product provider and even client preference.

The heavy emphasis on cost does not consider product structure, purchase options and other features, alignment with investors' risk profiles, return history and the non-monetary benefits to clients of receiving financial advice. The monetary value of financial advice over the long term is well documented.

Considering the above we would ask that you recognize that there is a cost of the valuable advice provided; and that a registrant should be able to take into consideration legitimate and subjective factors.

The Federation appreciates the opportunity to comment on the Proposals. We would be pleased to provide further information, and/or participate in any additional general or targeted consultations or answer any questions you may have. Please feel free to contact me by email at sandra@kegieconsuslting.com or by phone 416-621-8857

Regards,

Federation of Mutual Fund Dealers

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