PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

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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
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Notice and Request for Comment: Proposed Amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. Reforms to Enhance the Client-Registrant Relationship

Overview

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to provide comments on the Canadian Securities Administrators' (**CSA**) notice and request for comment on proposed amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) and to Companion Policy 31-103CP - *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the **Companion Policy** and, all together, the **Consultation** or the **Client Focused Reforms**). Capitalized terms in this letter have the same meaning as those given to them in the Consultation.

PMAC represents over 260 investment management firms registered with the CSA to do business in Canada as portfolio managers. PMAC members encompass both large and small firms managing total assets in excess of $1.8 trillion for institutional and private client portfolios.

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. In fact, that is PMAC's mission statement: advancing standards. The integrity of the client-registrant relationship is of crucial importance to confidence in the markets, a healthy Canadian economy and access to investment advice for all Canadians. To us, ensuring broad access to investment advice that is provided with the highest levels of integrity and skill is in the best interest of Canadians as a whole.

We would thank the CSA for the work done by its members to draft the Consultation and for the opportunity to participate in discussions on the important proposals in this Consultation. Our response is focused on the implications that the Client Focused Reforms may have for firms

registered with the CSA as "portfolio managers", for their registered individuals, and on the resulting impact of these proposals on their clients.

General Comments

We consistently support measures that elevate industry standards and improve investor protection. While we remain concerned about the net beneficial impact to investors and the applicability of some Client Focused Reforms to portfolio managers and their clients, we view several proposals in the Consultation as welcome opportunities to improve the registrant regulatory framework, as well as the CSA's enforcement capabilities, for the benefit of all stakeholders.

PMAC values the extensive work done by the CSA to respond to the comments received on CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward Their Clients* (**Consultation Paper 33-404**).

In particular, PMAC applauds the CSA for proposing a set of nationally harmonized reforms to NI 31-103. The harmonized proposals represent a very positive and important development *vis-a-vis* the proposals in Consultation Paper 33-404. We believe that this unified approach will avoid jurisdictional fragmentation, regulatory arbitrage and increased regulatory complexity.

Our submission proposes what we believe to be workable alternatives to achieving the CSA's Consultation goals. We are doing so because PMAC has serious concerns that the imposition of the full suite of Client Focused Reforms on portfolio managers does not strike the proper balance between investor protection and fostering efficient capital markets.

PMAC is concerned that, as drafted, the Client Focused Reforms will result in significant regulatory and financial burdens that may not improve investor protection, or effectively satisfy the CSA's stated policy concerns. We also believe that without a carve-out for non-individual permitted clients (including for their managed accounts), there will be a negative impact on the competitiveness of Canadian asset managers.

Our primary recommendation to more effectively address the main investor protection concerns associated with the portfolio manager registration category is as follows:

We request that the CSA reiterate the fiduciary duty owed by portfolio managers to their clients. This will provide the duty of care and professionalism framework within which certain of the enhanced Client Focused Reforms can be implemented. For example, we support the application of titling and holding out reforms, as well as certain aspects of the enhanced KYC, suitability, conflicts of interest, and disclosure proposals.

More principles-based guidance that has been tailored to the portfolio manager registration category is required with respect to the remaining proposed Client Focused Reforms. For instance, we believe that, as drafted, the proposed KYP requirements and amendments to referral arrangements are unworkable for portfolio managers and their clients.

We view the restatement (or clarification) of the fiduciary duty as an effective and efficient way to meet the CSA's investor protection objectives while not "muddying" the waters with overly prescriptive regulation which ultimately risks compromising the professional and ethical judgement that is fundamental to the relationship between portfolio managers and their discretionary account clients. We believe this alternative approach with respect to portfolio managers would address the investor harms set out in the Consultation and strike a proper balance between proportionate regulatory burden, fostering the efficient functioning of the capital markets, and preserving investor choice. We also believe this approach has the benefit of aligning with that of the U.S. Securities and Exchange Commission (**SEC**) - an alignment which can help to sustain Canada's continued competitiveness.

PMAC appreciates the efforts of the CSA to address areas of concern with the registrant-client relationship. As with much of the Consultation, the policy reasons cited in Annex E – Ontario Local Matters (**Annex E**) for the necessity of the wide-spread amendments to NI 31-103 do not always resonate when considered in the specific context of portfolio managers. We ask the CSA to reconsider the impact of the Consultation's messaging that implies that portfolio managers require an elevated standard of care through the imposition of prescriptive requirements in NI 31-103 when they are already bound by a fiduciary duty.

We have set out the specific aspects of the Client Focused Reforms that we believe should apply to portfolio managers – whether to codify best practices, for investor protection, or to enhance the CSA's ability to conduct insightful and efficient audits. We have also set out the aspects of the proposed Client Focused Reforms from which we believe portfolio managers should be exempt.

PMAC is advocating for the following with respect to specific Client Focused Reforms:

1. Carve-outs from certain of the Client Focused Reforms for non-individual permitted clients, including for the managed accounts of those clients.

2. Far more tailored KYP requirements that reflect the realities of portfolio managers' businesses, securities, and clients. As currently drafted, most of the proposed KYP requirements are inapplicable or unworkable in this context and portfolio managers should be exempt from their application.

3. Enhanced KYC and suitability obligations which are more clearly scalable to portfolio managers' business models and that account for limited mandates and specific client-types.

4. New and enhanced disclosure requirements should be more responsive to investor expectations and understanding. PMAC is concerned that the proposals simply amplify the amount of disclosure to be produced without a corresponding investor benefit.

5. Significantly more principles-based conflicts of interest provisions that include a materiality threshold would permit the reasonable implementation of these proposals and, we believe, promote investor understanding. The conflicts of interests provisions should, amongst other things, reflect PMAC's concerns with respect to proprietary products.

6. A separate work stream for additional consultation on the referral arrangement prohibitions is required, as we believe those rules will have a material adverse impact on stakeholders. Our submission suggests alternative prohibitions and enhancements to referral arrangements for consideration by the CSA.

The body of our letter is structured under the following headings:

1. Summary of PMAC's key recommendations;
2. One-size-fits all regulation is highly problematic;
3. PMAC's detailed response to the Client Focused Reforms; and
4. Concluding comments.

1. Summary of PMAC's key recommendations

A. Portfolio managers have a fiduciary duty which should be restated and clarified; not "muddied" with overly prescriptive regulation:

- We ask the CSA to publish a reiteration of the fiduciary duty portfolio managers owe clients, recognizing that an overarching and elevated duty of care is an effective incentive towards compliance with both the letter *and* spirit of the law.

- Clarification of the fiduciary duty can be supported through the imposition of selected Client Focused Reforms that have been tailored to portfolio managers and that address the CSA's investor protection concerns for this particular registration category.

- PMAC believes that discharging one's fiduciary duty and complying with the Client Focused Reforms is not the same thing. The former imposes a higher, overarching duty of care, regardless of the written rules. The latter would impose prescriptive guidance, alongside material compliance and cost burden, which in many instances do not apply to portfolio managers and their clients.

- Our submission aims to illustrate the ways in which a combination of the fiduciary duty and selected Client Focused Reforms (specifically, titling and holding out, certain aspects of enhanced KYC, suitability, conflicts of interest, and disclosure, along with alternative KYP requirements based on the comments provided here), would be beneficial for all stakeholders, including firms, the CSA, and investors.

B. More tailored regulation is required for portfolio managers:

- Portfolio managers are fiduciaries and professionals. These are important characteristics that we view as warranting a less prescriptive and more principles-based regulatory approach that fosters professional and ethical judgement.

- The Client Focused Reforms are insufficiently tailored to address the portfolio manager registration category. The Consultation's primary focus appears to be registrants, other than portfolio managers, with retail clients. As a result, the proposals sometimes miss the mark regarding the realities of portfolio managers' clients. Several proposals are inapplicable for a variety of portfolio managers' business models.

- We believe the CSA should more fully articulate the specific investor harm they seek to address and focus on the specific aspects of the Client Focused Reforms that are required to either enhance the protection of portfolio managers' clients and/or to assist the CSA in conducting efficient regulatory audits.

- The CSA should defer to the professional judgement of portfolio managers (including portfolio managers that carry exempt market dealer (**EMD**) registrations) with respect to requirements for which prescriptive regulatory enhancements are not truly required.

C. Carve-outs for non-individual permitted clients support efficient and internationally competitive capital markets:

- The CSA should re-introduce the carve-outs for sophisticated clients that had been proposed in Consultation Paper 33-404 but which did not carry over into the Client Focused Reforms; this is critical to preserving Canada's international competitiveness and to ensure the imposition of a proportionate regulatory burden.

- We request that the managed accounts of such non-individual permitted clients also be exempt as a failure to do so would create undue burden without corresponding investor protection benefits.

- These types of investors are sufficiently protected by the investment management arrangements or agreements (**IMAs**) and investment policy statements (**IPS**) they enter into with portfolio managers, combined with an elevated duty of care.

- We further believe that the imposition of the full suite of Client Focused Reforms on sophisticated investors will not appropriately meet client expectations. These sophisticated clients are able to negotiate for the protections they require, tailored to their individual circumstances and objectives.

D. Efficient markets require the ability to identify bad actors without regulating to the lowest common denominator:

- We appreciate that the CSA seeks to fulfill its critical gatekeeper function through the Client Focused Reforms. For this reason, alongside certain of the Client Focused Reforms, PMAC supports measures that would increase the enforcement capabilities of the CSA to target bad actors.

- PMAC sees strengthened CSA enforcement capabilities as a viable tool to use in tandem with selected regulatory enhancements to realize the objectives of the Consultation.

- A regulatory approach that is more closely focused on identifying, investigating and, if required, revoking the registration of those who violate securities laws could be, in our view, a more effective and proportionate way to govern the conduct of the lowest common denominator than a prescriptive and all-encompassing regulatory framework.

Note: *The majority of our over 260 members have identified the proposed KYP requirements and the referral arrangement amendments as presenting the two largest challenges created by the Client Focused Reforms.*

E. Know Your Product:

- PMAC believes that the know your product (**KYP**) proposals are not aligned with how portfolio managers operate or their clients' expectations and, for this reason, several aspects of these proposals should not apply to portfolio managers.

- We do, however, commend the CSA's responsiveness to many stakeholder comments on the KYP requirements in Consultation Paper 33-304.

- Any alternative KYP requirements proposed by the CSA for portfolio managers should be more principles-based and should account for the proficiency and professional qualifications of advising and associate advising representatives. They should also take into account that portfolio managers' suitability assessments already imply having conducted a rigorous KYP process, sufficient to discharge their fiduciary duty of care towards investors.

- PMAC's concerns regarding the KYP proposals arise on several fronts:

    - They are, in many cases, not applicable to portfolio managers' business models and/or to the ways in which individual registrants interact with security selection.

    - There are concerns surrounding their application and interpretation, specifically regarding what kind of analysis must be done with respect to equity securities, fixed income, index funds, pooled funds, and funds managed by a portfolio manager.

    - If they are implemented as drafted, the KYP proposals are very likely to result in increased compliance cost for firms and their investors. As a consequence of having to undertake and document the prescribed KYP analysis on the securities in their portfolios, the requirements may lead to a reduced universe of offered securities, without corresponding investor benefit.

F. Referral arrangement prohibitions risk significant unintended investor and stakeholder impact; separate consultation required:

- The potential impact of these proposals on both industry and investors merits a separate CSA work stream[1]. This would allow for a more thorough round of public consultation.

- We have identified material adverse (and, we believe, unintended) consequences arising from the proposed referral arrangement amendments. We view certain referrals as bolstering a network of independent professionals to assist clients in meeting their investment goals.

- PMAC has proposed an alternative set of prohibitions, as well as a corresponding set of enhancements, to existing referral arrangements to assist the CSA in next steps on this important issue.

[1] We support the approach taken by the CSA in respect of proficiency reforms set out in CSA Staff Notice 33-319 – *Status Report on CSA Consultation Paper 33-404*. PMAC believes that separate work streams are an effective way to devote appropriate consultative and regulatory resources to more complex areas while prioritizing issues of more immediate importance.

- PMAC would like to work collaboratively with the CSA to more appropriately ring-fence certain arrangements, while preserving and clarifying the existence of others that we view as serving the best interest of investors. We believe these arrangements help to address many of the CSA's investor protection concerns set out in the Consultation, including with respect to information asymmetry, access to advice, and "right channeling" investors.

G. Conflicts of interest:

- PMAC believes the conflicts of interest requirements should be limited only to material conflicts. To do otherwise would pose a significant burden on firms that we do not see as benefitting investors.

- A more principles-based approach to conflicts for portfolio managers would address the CSA's investor protection concerns without imposing a form over substance requirement that necessitates the creation of documentation to evidence compliance with the existing fiduciary duty.

- PMAC urges the CSA to leverage their behavioural economics expertise – both on the issue of conflicts, as well as disclosure in general - to propose for public comment disclosure that resonates with investors. This disclosure should aim to positively impact clients' understanding of material conflicts, of their portfolios, and of their relationship with their portfolio manager.

H. Know Your Client & Suitability:

- PMAC believes that proper KYC assessments are a cornerstone of the client-registrant relationship. We support the CSA's efforts to codify certain best practices around these crucial elements, including for portfolio managers.

- However, non-individual permitted clients, including the managed accounts of such clients, should be exempt from the enhanced KYC and enhanced suitability requirements, as a result of their sophisticated investment knowledge and their ability to contract for the protections they expect.

- Similar to PMAC's comments on Consultation Paper 33-404, we continue to have concerns that the broadened scope of information required to be collected by registrants could have the unintended consequence of exacerbating the expectations gap. This could cause investors to believe they are receiving tax or full-suite financial planning advice that is outside the scope of the agreed upon professional relationship and/or that is outside the scope of the adviser's proficiency.

- Deference should be given to portfolio managers' professional judgement so they can determine the KYC information required to be collected. The CSA's expectations around KYC should be dependent on what information is required to be collected to serve the client and these expectations should be highly dependent on business model, client type, and mandate.

- We ask the CSA to review PMAC's comments on the importance of referral arrangements as a way for clients to access other financial advisory services alongside our concerns with the expanded KYC proposals in mind.

I. Disclosure:

- PMAC supports enhanced transparency and impactful ways of communicating with investors.

- We recommend that the CSA study and determine the most effective ways to convey information to investors and would welcome consultation on disclosure that will promote increased engagement and client understanding.

- PMAC is concerned that requiring portfolio managers to provide enhanced disclosure to prospective clients beyond what is currently required under NI 31-103 is likely unworkable and may not be helpful without an accompanying prospective client meeting.

1. One-Size-Fits All Regulation Is Highly Problematic

Portfolio managers are professionals whose judgement should not be supplanted by overly prescriptive regulation

Portfolio managers are unlike other registrants and should be regulated differently to ensure proportional regulatory burden and continued investor access to this highly professional advice and to a diversified universe of securities and investment strategies.

Three important overarching principles differentiate portfolio managers from other registrants:

1. As fiduciaries, portfolio managers are bound by the highest duty of care to their investors. This is true regardless of asset class, investor type, or business model;

2. As registrants, portfolio managers are subject to the most stringent regulation, capital, and insurance requirements under NI 31-103; and

3. As professionals, portfolio managers are required to obtain and evidence the very highest degree of proficiency and relevant investment management experience (**RIME**) of any other registrant category.

We believe the combination of these three factors means that portfolio managers are the most qualified and experienced channel through which investors can obtain investment management advice. It is our hope that preserving and promoting investors' access to this type of advice is a CSA priority.

While recognizing that all members of the CSA engaged in serious negotiation and consultation to arrive at these nationally harmonized Client Focused Reforms, without the overlay of a separate best interest standard, we believe that a missing element of this Consultation is an explanation why portfolio managers ought to be subject to the wholesale application of these proposals. We urge the CSA to approach the regulation of portfolio managers differently than currently proposed under the Client Focused Reforms.

The Consultation does not reference the fiduciary duty

The fiduciary standard is the gold standard of duty and conduct towards clients and, for this reason, PMAC is disappointed that the CSA has not acknowledged in the Consultation, nor codified in the proposed amendments, the existence or importance of the fiduciary duty owed by registered portfolio managers to their investors. Given the focus of the Consultation on raising standards, the fact that over 600 CSA registered portfolio managers already have this standard of care – whether

by statute or common law – and that the fiduciary is not emphasized seems to be a material oversight. This is especially true since the CSA states at the Consultation's outset:

> After extensive consultations with stakeholders, we are proposing changes that we believe will achieve our stated goals of better aligning the interests of registrants with the interests of the clients, improving outcomes for clients, and making clearer to clients the nature and the terms of their relationships with registrants. [emphasis added]

PMAC believes that, by not recognizing the importance of the fiduciary duty owed by portfolio managers to their clients, the CSA is doing a disservice to the clients we serve and to the Canadian asset management industry. For investors, we believe that ignoring the fiduciary duty obfuscates important distinctions in categories of registrants and of investor choice.

The CFA Institute's Next Generation of Trust Report (**Report on Trust**) notes:

> Trust is an important factor when clients decide on a firm or adviser to hire, and it is an indicator of the health and term of the relationship – both for the potential to expand it, or the risking of losing it.

The Report on Trust notes that, for 35% of private clients, the most important attribute considered when hiring a financial adviser/asset manager is that their adviser is trusted to act in the client's best interest. For institutional clients, this statistic is 24%.

The CSA's approach in the Client Focused Reforms marks a stark contrast to recent rule proposals from the SEC which set out, on the one hand, a "regulation best interest" standard for broker-dealers' retail clients and, on the other, a separate proposal clarifying and offering additional guidance on the fiduciary duty owed to clients by investment advisers. We believe that the CSA should embrace the same regulatory approach and, along with it, seize the opportunity to enhance stakeholder awareness of different advice options, while striking the proper balance between improving investor protection and fostering fair and efficient capital markets.

NI 31-103 has striations of registration categories that are appropriately reflective of a variety of business models, proficiency and professionalism. Registrants are bound by the obligations and exemptions of their registration categories and to be silent about these differences in regulation does a disservice to stakeholders, especially to investors. PMAC continues to believe this will only exacerbate both the expectations gap and knowledge asymmetry that the CSA is concerned about. In Annex E the Ontario Securities Commission (**OSC**) states that an anticipated outcome of the Client Focused Reforms will be to "raise the standard of conduct for registrants towards what clients expect it to be". Additionally, elaborating on concerns arising out of the expectations gap, the OSC notes:

> Most investors incorrectly assume that their registrants must always provide advice that is in their best interest. As a result, clients have misplaced reliance or trust on their registrants, resulting in opportunities for some registrants to take advantage of their clients and creating an expectations gap between clients and registrants. Most investors place too much reliance on their registrants, which exacerbates the agency problem inherent in the client-registrant relationship and can result in sub-optimal investments. Clients need to understand the nature of the relationship, and what level of trust and reliance they should afford their registrant. [emphasis added]

CSA registered portfolio managers owe investors a fiduciary duty of care and that it is the highest standard. It is higher than the essence of the client-first standard which the Client Focused Reforms seek to encapsulate.

We recognize that the CSA have expressed legitimate dissatisfaction with aspects of the existing regulatory regime. Nothing in our submission seeks to discourage the CSA from making amendments to NI 31-103 that would empower them to more easily oversee, review, and, if necessary, revoke the registration of any category of registrant. We do, however, wish to highlight our view – one we believe to be shared by the OSC and by the Financial and Consumer Services Commission of New Brunswick as a result of their statements in Consultation Paper 33-404 – that an overarching duty of care acts as a guiding principle to resolve matters, even those that cannot be imagined by any regulator – in the best interest of clients. Portfolio managers owe that duty and they use their professional judgement to exercise it under every circumstance. More prescriptive regulation will not prevent bad actors.

Proportionate regulation / cost concerns

Several aspects of the Client Focused Reforms seek to create best practices. PMAC supports the CSA's intention to advance these beneficial best practices. However, in several cases, our objection is to the very prescriptive nature of the amendments and the material increase in documentation that would need to be produced to evidence compliance with them.

PMAC has concerns about both the significant one-time transition costs forecast for registrants by the OSC in Annex E and the on-going compliance costs inherent in the Client Focused Reforms. As acknowledged by the OSC, these costs will be passed on to clients. PMAC is concerned that, without a careful balance, an unintended consequence of the Client Focused Reforms may be a reduction in clients' access to investment management due to increasing account minimums in order to permit firms to continue to service accounts while meeting these highly prescriptive regulatory obligations.

PMAC is particularly concerned that the costs of compliance with the Client Focused Reforms will more acutely impact the ability of smaller and mid-sized firms to service investors. For this reason, we implore the CSA to tailor the Client Focused Reforms applicable to portfolio managers and their clients in order to ensure that the compliance burden is, in fact, commensurate with the benefits that investors, the CSA, and the Canadian capital markets will experience as a result of their implementation.

Portfolio managers offer several different types of business models and, more than ever, through technology and pooled funds, are able to service a broader variety of Canadian investors. We believe that any cost pressure on firms that does not carry a clearly articulated investor protection or market efficiency benefit, should be carefully reconsidered.

Carve-outs for non-individual permitted clients, including their managed accounts

While many stakeholders, including PMAC, did not support the introduction of yet another sophisticated investor definition in Consultation Paper 33-404 (institutional client), we do believe that carve-outs for non-individual permitted clients, including for their managed accounts, are necessary to enable industry to properly service such clients and to impose a proportionate regulatory burden.

PMAC firmly believes that the non-individual permitted client carve-outs ought to treat the managed accounts of permitted clients in the same way as their other accounts. The CSA has expressly recognized this in proposed National Instrument 93-101 – *Derivatives: Business Conduct* (**NI 93-101**). PMAC applauds the republished version of NI 93-101 which was amended so that managed accounts of sophisticated investors (eligible derivatives parties or **EDPs**) can be treated in the same way as other accounts of EDPs.

Managed accounts of non-individual permitted clients do not require additional protections. This is because permitted clients are sophisticated investors and the fact that they have granted

discretionary authority to a portfolio manager to manage their assets should not change their classification.

We strongly urge the CSA to make the same changes throughout NI 31-103 in the context of managed accounts of non-individual permitted clients. The underlying rationale supports making such a change to reduce regulatory burden without compromising investor protection.

PMAC is pleased to see that the Client Focused Reforms contemplate carve-outs from the KYC, KYP, suitability, and conflict of interest requirements for fund managers in respect of their activities as an IFM. We believe that such carve-outs should extend to fund managers who are also registered advisers to their managed accounts for consistency.

An important note for this section, as well as for our entire submission, is that permitted clients more often than not come to a portfolio manager for a particular mandate. It is the permitted client (or the internal investment committee at the permitted client) that conducts research and approaches a portfolio manager for a specific mandate (e.g. fixed income). It is also not uncommon for larger institutional clients to have many managers providing investment management.

PMAC questions the different ways in which the CSA views the following situations: why is a managed account for a pension plan currently not permitted to waive suitability, whereas an investment in a fund by a pension is able to grant such a waiver? We believe this treatment for managed accounts is inconsistent with National Instrument 45-106 – *Prospectus Exemptions* (NI **45-106**) which includes registered advisers acting on behalf of a managed account as an "accredited investor". Furthermore, this approach in NI 31-103 is inconsistent in that both a registered firm and investment fund managed by a registered firm are considered "permitted clients"; registered firms will rarely be investing on their own behalf but, rather, will be investing client funds from managed accounts or managed funds.

An example of the need for non-individual permitted client carve-outs arises with respect to annual KYC updates. Institutional clients may not be as responsive to requests for annual KYC updates as private clients for a number of reasons, including that their objectives and risks may be clearly laid out in an IPS or IMA in addition to other requirements, including concentration limits.

Under NI 45-106, registrants can rely on the KYC and suitability analysis performed on a client by another registrant firm, provided the registrant reviews the records and determinations made by the first registrant. We believe that codifying a similar exemption in NI 31-103 would be an appropriate way to reduce paperwork and regulatory burden for both clients and firms.

Overall importance of permitted client carve-outs

We have reiterated the request for non-individual permitted client carve-outs throughout our submission under the relevant Client Focused Reform as a reminder of the ways in which these sophisticated clients neither want nor need legislated protections but can, instead, negotiate for what they expect, knowing all the while that their portfolio manager owes them a fiduciary duty of care.

2. PMAC's Detailed Response To The Client Focused Reforms

We recognize that members of the CSA view the status quo as unsatisfactory and we support certain amendments that would provide the CSA with additional tools to aid audit and enforcement against registrants that are not fulfilling their obligations.

Below are PMAC's thoughts and questions with respect to each of the Client Focused Reforms. We have organized these thoughts in the same order as the Notice and Request for comment portion of the Consultation.

1. Know Your Client

We request that non-individual permitted clients, including their managed accounts, be carved out of the proposed enhanced KYC requirements.

PMAC generally supports amendments that enhance registrants' KYC obligations to ensure they solicit appropriate information from investors. While many portfolio managers have already adopted best practices in this respect, we believe that the codification of certain requirements is warranted, while exemptions from others are necessary.

PMAC members embrace the imposition of enhanced KYC amendments on portfolio managers, subject to the following suggestions and questions.

Scalability

We request additional clarity in NI 31-103 – and not in the Companion Policy – to permit firms to scale their approach to the manner and scope of KYC collection.

In considering the scalability of the Client Focused Reforms, the CSA should note that certain portfolio managers have restricted mandates and that, in many cases, requests for certain information would be irrelevant and thus misaligned with client expectations and needs. Simply put, this requirement will add regulatory burden without value.

Portfolio managers have a duty to determine what range, breadth, and depth of KYC information is required from each type of client and in each situation and to then obtain and assess that information appropriately. We believe that the prescribed bullets under clients' personal circumstances in the Companion Policy should be simply examples of potentially applicable data points to gather, as opposed to a regulatory expectation. Realistically, the majority of sophisticated clients (be they permitted clients or high net worth investors) have outside advice from tax accountants, estates experts, and accountants, and may not wish to share this information with their portfolio managers.

The Companion Policy is too granular with respect to the aspects of KYC information to be collected under the enhanced requirements. The information to be collected should be dependent on how a portfolio manager frames KYC questions more generally. For example, a portfolio manager that asks clients what cash flow they need and how much they are able to save, does not necessarily need to know the number of dependents that client has. The question of how many dependents is related to required cash flow and other savings goals or investment strategies that can be assessed through other areas of inquiry in an equally valid way.

PMAC queries why importance is placed on a clients' investment knowledge when the client has hired a discretionary manager. In the same way that a doctor would not expect a patient to evidence the extent of his or her medical knowledge, clients of portfolio managers should be focused on the qualifications of their portfolio managers and not the other way around.

With respect to evaluating a client's risk profile, PMAC believes that the risk profile of the firm and its securities must also be factored into the analysis. Firms should be permitted to "right size" their practices and procedures based on the risk assessment and business model, similar to how firms are currently allowed to tailor their policies and procedures manuals. We believe a more contextual approach that defers to professional judgement can result in better outcomes. For example, when pension clients come to a portfolio manager, they have a mandate which sets out the parameters of what the plan needs. The prescribed risk profiling would be neither applicable nor helpful to a client of this nature.

Scope of KYC information required varies and may trigger privacy law concerns

Portfolio managers should be permitted to rely on their professional judgement to determine what information is, in fact, required from a client. We feel that the Companion Policy guidance regarding the KYC proposals should be amended so that portfolio managers that service high net worth clients who may only have a small portion of their overall wealth with any one registrant are not required to evidence a full breakdown of such clients' financial assets and net worth.

Further, many firms' privacy policies generally require the collection of only such information as is necessary to carry out their mandate. The collection of irrelevant information, though arguably mandated by the CSA, would be contrary to such polices and to the spirit of privacy laws. Changes to privacy laws in Canada, including the requirement to obtain meaningful consent under the *Personal Information Protection and Electronic Documents Act* (**PIPEDA**), coming into effect at the start of 2019, will mean that firms cannot require individuals to consent to the collection, use, or disclosure of personal information beyond what is necessary to provide a product or service. The enhanced KYC requirements could, in some instances, put firms in a position of being offside KYC expectations or being offside privacy law requirements.

Additionally, members are concerned that the collection of client information beyond what is necessary may give a client the impression that the portfolio manager is using all of this information — which is not the case when they are engaged in a limited mandate. There are several concerns raised by this requirement, including the notion that an institution should not have too many eggs in one basket, so to speak: from a portfolio manager perspective; from an investment diversification perspective; as well as from a data security perspective.

"Meaningful understanding" and "thoroughly knowing" the client

We support the CSA's expectation that registrants have a meaningful understanding of clients' investment needs and objectives. We also support the statement in the Consultation about the need to preserve the technology-neutral stance of NI 31-103.

We note that some concepts introduced in the Client Focused Reforms may require further examples and explanations. For instance, the requirement that "the KYC process result in registrants thoroughly understanding the client" and the expectation that registrants have a "meaningful understanding of their client's needs and objectives" are both laudable goals, but could benefit from examples of when the CSA will deem a firm to have met these expectations.

The same applies to the rather subjective expectation that firms must update a client's KYC information when the registrant knows or "reasonably ought to know" about a significant change in the client's KYC information. We believe that the "reasonably ought to know" commentary should be removed as clients are better positioned to advise of a significant change. Alternatively, we request clarification that firms that undertake reasonable measures to update KYC on a timely basis or that contractually require a client to advise them of changes in their circumstances will have discharged this duty and that this expectation does not impose an unduly onerous obligation on the firm to engage in ongoing monitoring of a client's activities or life, for example, through social media or other means.

Information that goes beyond investment management

We believe that KYC and suitability obligations that extend beyond securities-related strategies, such as collecting clients' basic tax information, may do a disservice to clients by misleading them into thinking that registrants are providing certain services or advice when that is not the case.

The Companion Policy states with respect to client's investment objectives that:

> Depending on the nature of the relationship with the client, and the securities and services offered by the registrant, 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 securities.

PMAC continues to believe that this is not an appropriate expectation to have of portfolio managers with respect to their clients. We recognize that the language in the Companion Policy is couched such that there is, theoretically, room for the registrant to determine whether the guidance applies. PMAC remains concerned that, without carve-outs for portfolio managers, this guidance could be deemed to apply at a later date, or during the course of a regulatory audit and we do not believe that would be appropriate or necessary to protect investors.

Portfolio managers provide discretionary investment management and should not be confused for or treated as financial planners, unless they are and hold themselves out as providing such services. PMAC refers the CSA to our comments in this submission on the importance of preserving certain types of referral arrangements to ensure that investors are, in fact, able to access a variety of financial services and investment advice.

We are concerned about any expectation that portfolio managers must provide any estate, tax or financial planning advice, as this is not their core competency. There are many instances in which such an expectation on the portfolio manager would be inappropriate and could further the expectations gap. To continue using the example of a portfolio manager with a large pension plan as a client, it would be wholly inappropriate for the portfolio manager to suggest what the plan ought to do with its assets or liabilities since the portfolio manager is retained on a limited mandate basis and only for a portion of the client's assets. Furthermore, pension plans employ consultants and actuaries who provide these specialized services which are different from the skill set and expertise of a portfolio manager.

Other

PMAC believes that the KYC requirement to verify the identity of an individual client is duplicative of firms' obligations under Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime client identification requirements and should be omitted.

With respect to the codification of annual KYC information updates, instead of being required to update KYC on an annual basis, PMAC requests that the CSA permit firms to make best efforts to do so. Annual KYC updates are not a sufficient or appropriate substitution for proper and open lines of communication between a portfolio manager and their client, though they can certainly be a starting point for that dialogue.

2. Know Your Product

We request that non-individual permitted clients, including their managed accounts, be carved out of the KYP requirements.

PMAC appreciates why the CSA sees the need to impose express KYP requirements in NI 31-103 and to amplify the guidance on KYP in the Companion Policy for certain registrants. PMAC also applauds the CSA's responsiveness to the many comments and concerns raised as a result of the proposals in Consultation Paper 33-404 on mixed and proprietary product shelves.

KYP is an integral aspect of a portfolio manager's duty to clients and to a registrant's business. However, certain of the prescribed KYP obligations – especially the requirement for a comparison of "products" - are emblematic of the problematic outcomes that may be created by the Client

Focused Reforms if the same set of obligations and guidance is imposed on portfolio managers as on dealers.

The imposition of the proposed KYP requirements is unlikely to lead to a logical outcome, as we do not believe that their implementation would move the dial and address the CSA's proprietary versus third party product issues with respect to the wider registrant population. Further, the KYP proposals appear to be a complex solution to a problem that has not be clearly identified in the portfolio management space.

Our concern is that the KYP requirements, as drafted, will result in reduced securities options being made available to investors in order to allow firms to manage the cost of this obligation, without a corresponding investor benefit.

We also reiterate that, embedded in a portfolio manager's suitability obligation is a thorough KYP process, but it is a process that cannot and should not be prescribed as proposed in the Consultation.

Products versus securities

PMAC wishes to reiterate a comment submitted regarding the KYP proposals under Consultation Paper 33-404 which continues to be a critical issue under the Consultation: Portfolios are not product lists; they are investments. From a practical and a philosophical viewpoint, portfolio managers do not deal in "products" in the way that other registrants might. Portfolio managers create strategies for clients using various investments. Furthermore, portfolio managers do not have product shelves in the same way that other registrants do.

Accordingly, PMAC members are concerned that the implementation of the KYP proposals would be problematic, costly, and unnecessary. Without an appropriate carve-out or tailored regulation in this respect, portfolio managers will be left to grapple with how to comply with rules that deal with "products" when portfolio managers deal with securities and investment strategies.

Qualifications / standard of care

Advising and associate advising representatives should be exempt from certain of the KYP requirements based on their proficiency and RIME. Distinct from other registration categories, advising representatives and associate advising representatives are required under NI 31-103 to evidence the highest levels of professional qualifications in order to become registered as such with the CSA. For advisers that have earned their Chartered Financial Analyst designation (**CFA**), we emphasize that CFAs are required to continuously refresh and update their investment knowledge. The CFA Institute notes the importance of maintaining and improving professional competence and recommends the completion of 20 hours of continuing education activities, including a minimum of 2 hours in standards, ethics and regulation, each calendar year. CFA holders annually attest to completing the minimum recommended hours for the prior year when they renew their CFA Institute membership. For portfolio managers who have earned their Charted Investment Manager designation (**CIM**), we highlight the annual requirement to renew the CIM designation through evidencing completion of prescribed continuing education credits. CIMs are required, as of January 1, 2018, to complete 20 hours of professional development and 10 hours in compliance during a 2 year cycle[2]. We ask the CSA to consider these ongoing obligations, overseen by professional bodies, as well as to remember that the adviser's fiduciary duty informs his or her need to understand the securities offered to investors, based on their own professional judgement of each unique firm model.

2 The continuing education content must fall within prescribed knowledge areas to renew a CIM designation and includes: regulation; ethics; standards of practice; sales and marketing; client discovery and interaction; analysis of environment; asset allocation and investing styles; security selection; derivatives; managed product selection; alternative investment selection; structured product selection; IPS; implementing the IPS; portfolio construction; portfolio monitoring, measuring and rebalancing; rebalancing; and portfolio reporting.

We see an analogy in these requirements for portfolio managers with a proposal that would require lawyers to document and explain their familiarity with each element of legal advice they relay to a client or to prove that they are an expert in each type of contract that they assist in drafting. Lawyers are required to earn their LL. B and to subsequently maintain and develop their professional knowledge on an ongoing basis, as required by law societies of the various jurisdictions of Canada. Like portfolio managers, lawyers also owe their clients an elevated duty of care. Using the example of lawyers, it would seem unduly burdensome and inappropriate to ignore the elevated duty of care and professionalism these experts have earned. PMAC contends that the same should hold true for portfolio managers.

We would have serious concerns with the imposition of additional record-keeping obligations on portfolio managers that would require additional documentation of a process that is already robust and working to the benefit of investors.

Firm versus individual KYP obligations

Portfolio managers will have to assess how the KYP obligations are evidenced both at the firm level, and at the individual registrant level – a compliance conundrum when the firm and CCO are responsible for the compliance program and adherence to applicable laws.

Portfolio managers will also need to assess the extent to which their individual registrants (whose role in security selection, pooled fund creation, or client relationship management may differ widely) are required document the full complement of prescriptive proposed KYP obligations. If an advising representative or associate advising representative (who understands the securities at a high level) and is solely client-facing and not involved in the research, selection and analysis of individual securities for investors, we query why the full suite of KYP obligations, as currently proposed in Sections 13.2.1(3) and 13.2.1(5), ought to apply.

The proposals currently recommend obtaining input from compliance and risk management in analyzing and approving securities. In the context of fixed income and equity securities, unless these individuals are portfolio managers, it is highly unlikely that compliance and risk management have more expertise than the portfolio managers and their team of analysts in ascertaining whether a security should be available for inclusion in the portfolio. Portfolio managers and their analysts are employed to conduct this very analysis because of their proficiency and RIME.

Additionally, we query how advisers that purchase or dispose of individual securities, such as equities or fixed income, can constitute a product review committee or obtain firm approval? More generally, we believe that it may be appropriate to ask advising or associate advising representatives to maintain the research reports they used to analyze and select specific securities for future audit purposes. But we do not believe that the full-blown KYP obligations are necessary in this instance.

Proprietary Products

We request that the KYP requirements not apply when the firm only has proprietary products which it has developed and manages, for example, a pooled fund. Knowledge of all factors outlined in the KYP requirements should be implied as part of the development of the fund and by virtue of the portfolio manager's proficiency.

For firms that only offer proprietary products, members query the necessity for such firms to conduct peer comparisons. Members take the view that this issue can be appropriately addressed through the conflict of interest and relationship disclosure requirements that highlight that the registrant is only offering proprietary products.

Pooled Funds

Many portfolio managers have pooled investment vehicles designed to implement a certain investment strategy or to satisfy a specific mandate for a client. Pooled funds are beneficial as they allow smaller investors to have access to investments they may not have otherwise had, as well as help reduce trading costs, since transactional costs are shared by all investors in the pooled fund. Pooled funds also carry with them the benefit of fairness in trade allocation. Additionally, certain portfolio managers may invest their clients in a universe of securities based on the firm's unique expertise, focus, sector, or even micro-niche, and investors hire these portfolio managers for access to that particular specialization. This is a fundamental difference in the services portfolio managers provide to clients. Portfolio managers who have pooled funds are the creators of their own "products". It does not make sense to impose upon them a requirement to then prove they know the product they themselves created. It is not clear how the proposed KYP process can be undertaken in this context.

Generally, PMAC believes that the guidance in the Companion Policy fails to reflect the realities of many portfolio managers that invest their client assets in pooled funds. Guidance that accounts for these pooled funds or that specifies the CSA's expectations with respect to pooled funds would be helpful. Reflecting on the additional regulatory burden that will be imposed on portfolio managers with pooled funds, some smaller members have expressed concern as to whether they will be able to justify the costs – an important consideration due to the access and lowered transactional costs that pooled funds can offer certain investors.

Index funds

For portfolio managers that advise index funds, we question the necessity for them to conduct KYP on the underlying securities as the index funds' mandates require the funds to seek to replicate a specific index through purchasing the underlying securities in that index. Portfolio managers are not permitted to deviate from their mandates. Accordingly, we believe that an exemption from the KYP requirements is justified in this respect.

Fund-of-fund structures

For funds that are top funds, the KYP requirements, as drafted, may result in reduced securities being made available for investors in order to allow firms to manage the cost of this obligation, without a corresponding investor benefit. Accordingly, we believe that an exemption from the KYP requirements is justified in this respect.

Peer comparisons

We request clarity from the CSA that individual security-to-security comparisons are not what was intended by the language in Section 13.2.1(a)(iii). The requirement to assess "how the security compares to similar securities available in the market" as part of the KYP requirement suggests that securities must be compared on an individual basis, as opposed to the more practical approach of comparing types, or "buckets" of securities.

In addition, it may be impractical to compare similar securities, particularly exempt market securities and private pooled funds, where information is usually not publicly available and is often subject to strict confidentiality provisions. A requirement imposed by the CSA to compare individual securities in a portfolio or pooled funds to other individual securities would be unworkable from several angles. Administratively, this would be a tedious and complex undertaking that we do not view as adding any investor protection. Moreover, firms are concerned about sharing the individual securities in their pooled funds because of fear of market manipulation and would not be able to share securities that are currently under accumulation. We also note that most non-individual permitted clients have full teams in-house to compare products and these clients would not want or expect a costly comparison to be done for them by the portfolio manager.

PMAC is also unsure what an analysis of the overall competitiveness of the security would entail, as compared to a range of similar investment opportunities. We believe further explanation is warranted on this point.

Rather than an emphasis on peer comparisons, PMAC feels it is more useful to investors that firms' disclosure clearly, openly and honestly discusses their philosophy, geographic or sector focus.

Members query what cost-effective means of comparing securities exist that would satisfy the KYP obligations and whether the comparison would benefit investors working with portfolio managers. Moreover, when looking at ways to compare securities, members have noted with concern the rapidly rising fees for the use of benchmarks and indices and the impact of these rising costs on investors.

Members also raised the following additional questions and concerns about how and when to compare "products", since the comparison will be dependent on a specific time in the markets. Just because a competitor's fund performed well during the last quarter does not mean another firm's fund will not outperform it in the next quarter. Firms query how often the comparisons would need to be done to be reasonable. Firms also query whether it is the products that should be compared or products of portfolio managers with similar investment philosophies (i.e.: value investors only need to compare against other value investors.)

Model portfolios

Many portfolio managers have model portfolios available for investors, depending on their individual needs. The assessment of which model portfolio a client should be invested in is a product of a detailed suitability analysis for the client, not of the individual securities in the already-created model. For such advisers, prescriptive KYP requirements do not make sense. PMAC queries how a firm with five model portfolios would properly conduct a market comparison that satisfies the KYP requirements and that benefits investors.

Third party information

PMAC members query how firms with non-proprietary products can undertake a KYP analysis without, in some part, relying on a third party's assistance. The information from third parties forms the basis of the information the portfolio manager has on the securities and the CSA should expressly allow the use of third parties to help registrants meet the KYP obligations. Otherwise, firms would be required to hire their own personnel to perform this task when the information provided by issuers and independent third parties should suffice as a result of that information being subject to stringent requirements.

Clients that are registered firms, Canadian financial institutions or Schedule III banks.

For consistency and proportional regulation, we believe that the exemptions with respect to KYC and Suitability requirements under Sections 13.2(5) and Section 13.3.(3) of NI 31-103, respectively, should be extended to the KYP obligations. Such an exemption would provide that the KYP requirements do not apply if the client is a registered firm, a Canadian financial institution or a Schedule III bank.

Transfers-in and client-directed trades

The KYP proposals relating to securities in a portfolio ported by a client from a previous institution are problematic as they require firms and individual registrants to conduct due diligence in a number of scenarios.

Firms would be required to diligence securities prior to those securities being transferred into the firm. This is not consistent with industry practice and clients may not provide all of their holdings to a new firm prior to making the decision to leave a firm. It is more common for the client to transfer all of their holdings to the new firm and, within a reasonable period of time, to replace unsuitable holdings with ones that are more suitable. This is because there are often delays in transfers and, if a client is required to sell securities before submitting paperwork to leave the firm, the client may be out of the market for an extended period of time which is not in the client's best interest. Accordingly, we request that the transfer-in KYP process be amended to reflect existing practices which we believe are of benefit to the client.

Firms would also be required to monitor and reassess those securities. Clients may seek to have securities transferred into a single account for consolidation purposes (for example, if a client acquired those securities through their employment) or, sometimes, securities cannot be sold because they are illiquid or defunct. The registrant may have no expertise in those securities (for example, a fixed income manager being asked to assess equities), yet the proposals would require that registrant to diligence those securities and continue to monitor and assess them. PMAC is concerned that the requirement to monitor and assess may, in fact, give clients the impression that they can rely on the registrant to manage those securities, which is incorrect and inappropriate.

While the registrant could refuse to accept the transfer-in of those securities, the consequence for clients is that they would be required to maintain a second account at another registrant (which is likely to impose fees) or clients would be forced to liquidate securities when they may not wish to do so. As a result, we recommend that registrants be permitted to accept those securities, provided that, prior to the transfer, clients acknowledge in writing that the registrant will not perform any KYP, suitability, or on-going monitoring with respect to those securities.

With respect to client-directed trades, NI 31-103 currently imposes an obligation on registrants to obtain a client's written acknowledgment if the registrant is of the view that a trade is unsuitable and the client persists in wanting the trade to be executed. In our view, if a client persists in wanting to execute the trade, the registrant should not be required to continue to monitor and assess that security, as the registrant has already made a determination that the security is unsuitable.

Client Profiles

The discussion on client profiles in the Companion Policy appears to unnecessarily constrain portfolio managers in selecting securities for a client where the client fits in more than one guideline or client profile (i.e.: time horizon or liquidity needs), but not the others. What flexibility there is in these profiles is unclear from the Companion Policy discussion.

3. Suitability

We request that non-individual permitted clients, including their managed accounts, be carved out of the enhanced suitability requirements.

As with the proposals enhancing KYC and KYP obligations, we support the underlying rationale of the proposed suitability enhancements and believe that a properly undertaken suitability analysis is a cornerstone of professional investment advice in a client's best interest. We generally agree with the CSA that a holistic approach to suitability analyses is critical to making decisions that further clients' investment goals.

That having been said, by virtue of the discretionary nature of portfolio managers' relationships with their clients and the IPS between clients and advisors, portfolio managers are perpetually undergoing a suitability analysis with respect to their clients' portfolios.

We view the suitability obligation as ongoing and of paramount importance to the portfolio manager's discharge of her fiduciary duty toward the client and these portfolio managers should therefore not be subject to specific and prescriptive requirements.

Overall, members are concerned that an unintended consequence of these prescriptive suitability requirements will result in a regulator applying hindsight as a substitution for a portfolio manager exercising professional judgement in compliance with the rules and the overarching fiduciary duty. Our specific concerns are set out below.

Adjudication of suitability determinations

While PMAC members are alive to the importance of CSA guidance in the Companion Policy, we seek assurances that the CSA will neither adjudicate the advisor's decisions in hindsight nor supplant the regulator's judgement in place of the advisor's, codified in the rule under NI 31-103 proper, not just in the Companion Policy.

Prescriptive elements of KYP analysis

We query whether the requirements proposed in Section 13.3 of NI 31-103 which set out the multiple areas of consideration that a registrant must determine have been met prior to taking any investment action on behalf of a client, are necessary for portfolio managers. Alternatively, members wonder whether the CSA ought to reasonably expect a firm to be able to provide evidence that each such factor has been taken into consideration and satisfied. We believe that to do so is unduly onerous from a compliance and resource standpoint and that the overarching fiduciary duty of the registered firm serves as an appropriate, principles-based substitute for Section 13.3 of NI 31-103. Members are concerned that these criteria will make it more difficult for portfolio managers to fit alternative or specialized securities into their recommendations. Given the very specific mandates of certain portfolio managers and the overall desirability of diversification in client portfolios (in line with risk tolerances and objectives), any unintended consequence narrowing the universe of securities that are suitable is cause for concern.

In the Companion Policy, when the CSA refers to how they will review suitability determinations, we believe it is essential that the following underlined words be added in order to recognize the importance of limited mandates and sector focus:

> We will not review whether the suitability determination has been met based on events subsequent to the determination by the registrant, nor do we expect that there is only one best decision, recommendations or course of action: there could be several decisions or recommendations that the registrant has a reasonable basis for concluding are equally suitable and that puts the interests of the client first. Our review will be based on what a reasonable registrant <u>with a similar business model</u> would have done under the same circumstances.

Narrow mandates or portions of a client's overall wealth

Different types of accounts may have different objectives, time horizons and risk profiles, thereby requiring different types or mixes of investments. In addition, client relationships also vary - some are all-encompassing and cover the totality of the client's financial assets, where many others are limited to a narrow mandate or a portion of the client's overall financial assets. In situations where a portfolio manager is only providing advice on a limited mandate or for a portion of a client's overall assets, it would be impractical to assess suitability on a consolidated basis, as the portfolio manager may have limited or no access to information about the client's other assets.
For example, how would a registrant assess the liquidity needs or concentration of a registered retirement savings plan for a 40-year-old in conjunction with a cash account held for short-term or emergency needs?

Connected with the proposed KYC information gathering requirements, PMAC requests direction from the CSA as to what a portfolio manager should do if a client declines to provide information to support the suitability determination in the context of disclosing the client's total net assets. PMAC would expect that the registrant be allowed to make a suitability determination based on information provided by the client, while advising the client that information not provided with respect to total assets may impact investment suitability.

Lowest cost securities

Members are concerned that the implication in the Companion Policy that the lowest cost product is the most suitable for a client does not come with a materiality qualifier. Members also noted that this type of commentary is importing into a national instrument the notion that low cost or passive products are always the best for clients, without regard to other factors, such as the value of advice. Members have queried whether, when there are multiple classes of a fund with differing fee structures, established with different minimum investment sizes, placing a client investment in a higher-cost class due to the investment size is acceptable in meeting the expectation that the lowest cost security is provided.

To illustrate a scenario when cost may not be the only relevant consideration, we point to a scenario where there may be two investment options but the client has certain restrictions that preclude placing the investor in the lower cost security. In this scenario, firms are concerned about how they can justify the higher cost option in hindsight. We believe the answer is documentation of the analysis and reason for selecting the higher cost security.

A number of the discussions in the Consultation about the impact of product cost on the end result of a suitability analysis do not apply to portfolio managers for whom fees are paid as a percentage based on the size of the client's account and who do not charge other types of fees or commissions that would impact the suitability analysis. More principles-based guidance on these and other points would provide better scalability.

Cash holdings

Responding to comments in the Companion Policy about excessive cash, we believe that determinations about how much cash is excessive in any client's account should be left to the professional judgement of each portfolio manager based on each client's needs and market conditions. Members have noted the following instances in which clients might reasonably want to leave cash in their accounts: to pay account costs; for foreign exchange; timing the market; getting into the market slowly after sale of a business; purchasing a business in the short term but looking for the right opportunity; or to meet upcoming expenses. Additionally, certain funds are only traded monthly or quarterly and the transactions entered into by those funds may occur intra-month or intra-quarter. The inability to hold cash for those periods would result in difficulty settling transactions or disposing of securities in anticipation of redemptions.

By imposing a limit on cash holdings, portfolio managers could feel forced to purchase securities that are not optimal or that are not at optimal prices – conflicting with the portfolio manager's fiduciary duty. Investment decisions should remain in the sole judgement of portfolio managers.

4. Conflicts of Interest

Referral arrangements

We ask the CSA to move this important project into a separate work stream to allow for the further collection of data, to evaluate and react to the responses received on these newly proposed rules.

While we note that the CSA has proposed a slightly longer transition time for the implementation of the proposed referral arrangement rules, PMAC believes that another round of public consultation

on this issue is critical due to the potential magnitude of their impact. This is also true since the Consultation marks the first time these proposals have been presented for public comment.

PMAC recognizes that the CSA have reviewed referral arrangements that, justifiably, raise investor protection concerns and that these proposals are a first step towards curbing certain practices and compensation arrangements. PMAC understands that the OSC, in particular, as set out in Annex E, views amendments to the current referral arrangement rules as an important ring-fencing and investor protection measure.

PMAC members have voiced strong concerns about the unintended consequences that the proposed amendments on referral arrangements may have on stakeholders, especially on investors' access to advice.

We believe a more appropriate balance could be struck to address the CSA's concerns, preserve investor choice, and access to portfolio managers - including smaller and mid-sized firms. Moreover, the proposals could have the unintended consequence of adversely impacting lower-margin firms servicing lower-wealth investors. We have endeavoured to set out what we feel are preferable alternatives to address the real issues created by certain referral arrangements in lieu of a wholesale overhaul of the currently accepted framework. PMAC wishes to work with the CSA to help achieve this end goal in a way that is sensitive to the variety of referral arrangements working to the benefit of investors, as well as to discontinue problematic arrangements.

We believe it is important to set out the variety of relationships and agreements that portfolio managers currently have in place which would be impacted by the proposed prohibitions on certain arrangements. For example, there are currently referral arrangements with portfolio managers where an ongoing service (e.g. financial planning) is provided to a mutual client. In other words, this type of arrangement falls under the definition of "referral arrangement", as drafted but should be more properly considered a service arrangement where the portfolio manager is simply collecting the fee for the service partner and remitting it to the service provider. Certain of the most prevalent beneficial arrangements are discussed in Appendix **A** to this letter, though others exist that are too numerous to meaningfully address fully in this submission. Appendix **B** addresses certain of the OSC's policy concerns arising out of Annex E, as we feel certain assumptions contained in Annex E require additional information and consideration.

As part of the CSA's next steps, we believe that additional information regarding the specific investor harm(s) the CSA is seeking to address through their prohibitions is required to help stakeholders formulate an alternative policy response. Members have also indicated that a better understanding of the scope of clients' assets under management that are subject to referral arrangements would help to ensure that the regulatory response is proportional and not overly disruptive.

PMAC has the following concerns with respect to the proposed referral arrangement amendments:

I. Prohibition on payments to non-registrants

There are examples set out in Appendix A of non-registrants contracting with registrants to provide value, context, and services to investors through referral arrangements. Of particular importance to an aging population is access to tax, financial, and estate planning experts who work in tandem with portfolio managers to holistically map out a clients' goals and help them navigate how to attain those goals. While incredibly valuable, portfolio managers know that investment management is only one part of the bigger picture of financial health.

A prohibition on paying fees to non-registered referral agents is likely to significantly disrupt investors' access to portfolio managers. As a consequence, they may be referred to another person employed in the financial sector that may not owe the investor a fiduciary duty of care, nor be obligated to undertake a sophisticated KYC, KYP and suitability analysis. For non-individual

permitted clients, the referral may be directed to foreign advisers who are not subject to such restrictions. These foreign advisers may not have significant assets in Canada and, as a result, actions against them could be more difficult to enforce.

Some, though not all, portfolio management firms have built their business model based on client referrals through non-registrants, as is currently permitted under NI 31-103. These firms would experience significant disruption to the detriment of their ability to provide highly professional investment management to their clients.

II. 36 month time limit on referral payments

PMAC is concerned that time and fee limits, as proposed, will not ultimately eliminate compensation-based conflict as the referral agent is incentivized to seek to contract with the party that can provide the highest remuneration for the longest period of time – whether or not the investor is being "right channeled" to a registrant.

For referral arrangements that continue to be permitted, the proposed 36-month time limit on referral payments remains a commercial concern as well as an investor-protection concern.

It is our belief that limiting the period of time for which a payment or series of payments can be made to a referral agent will prompt "churning" by the referral agent at the end of each three-year period. We do not believe that incentives for a third party to churn should be codified in NI 31-103 and encourage the CSA to develop a more principles-based approach.

Limiting the period in which a registrant can pay a referral fee may not align with any ongoing services provided to a mutual client. In other words, if a mutual client is receiving financial planning or accounting services from a referral agent that are continuous services, then a referral fee (or service fee) should be permitted to be paid for as long as the service is being rendered.

The parties, subject to the agreement of the registrant, should determine the appropriate length of time for the payment of such fees. There are a wide variety of referral arrangements and we do not believe that all of them should be required to terminate after three years.

As set out below, PMAC's proposed annual disclosure to investors of the referral fees paid to referral agents adds a layer of transparency and investor scrutiny as to the quantum of fees and the length of time over which such fees are paid.

III. 25% fee cap on referral payments

There are concerns that a fee cap will result in regulatory arbitrage away from portfolio managers and other registrants governed under NI 31-103 to parties that offer other products and securities but are not bound by similar fee limits. PMAC members believe that the proposed prohibitions could create a material financial incentive to refer clients away from registrants, creating an unlevel playing field between professionals who are overseen by the CSA and those who are outside of the ambit of NI 31-103. For example, individuals who offer segregated funds would not be subject to the CSA's referral arrangement rules and, as a consequence, the referral fees payable by such persons would *not* be capped.

Ultimately, we believe this would have a negative impact on firms and investors and undermine the CSA's intent of strengthening regulation under NI 31-103 for the benefit of stakeholders.

Portfolio managers who create investment management services for lower-wealth clients, such as online advisers, would also be punished by a percentage cap on fees payable as their margins are, by necessity, smaller in order to allow them to service what is often a lower-wealth segment of the Canadian population. These portfolio managers can play an important role in addressing the CSA's

concerns over an advice gap and we believe that regulation ought to ensure a level playing field for traditional firms as well as new entrants and innovative business models.

We believe that an important consideration in determining the appropriate parameters for referral arrangements is the existence of other individuals who can pay referral agents more and for a longer period of time. We appreciate that there is a delicate balance to be struck and that the CSA does not have the jurisdiction to regulate firms and individuals beyond NI 31-103, but it is important that the prohibitions not create a disincentive for a referral agent to "right channel" a client towards a portfolio manager.

PMAC members have queried how the CSA arrived at the 25% cap on fees or commissions received from the client by the party receiving the referral. PMAC wonders whether there is evidence to support that at 25% of fees, referral agents are less likely to undertake registerable work than they would if they received 40% of fees, or some other percentage.

Members are concerned that setting a fee that is substantially lower than some existing arrangements would require renegotiation of existing agreements and that these - and any new referrals that a referral agent may consider making to a portfolio manager - could instead incentivize a referral agent to send a client to a non-regulated entity.

For example, if a client in rural Alberta were to sell her family's farm and, all of a sudden, have $2 million in investible assets, we believe that policies should not disincentivise the investor's financial planner from referring her to a portfolio manager. For additional clarity, if the financial planner referred the business and s/he was no longer going to provide financial planning services, a referral payment could be made by the registrant to the financial planner. If the financial planner will continue to provide services to the client, then a service fee could remitted to the financial planner by the portfolio manager.

We ultimately believe that imposing a hard cap on permissible fee payments to referral agents is not an advisable approach to what is an admittedly perplexing problem. To illustrate why we believe this is not the correct approach, we use an example of the ways in which imposing a hard cap on the percentage of fees payable by a portfolio manager could hamper competitiveness and eliminate fee schedules that benefit investors: A portfolio management firm has created a fee schedule for clients in its pooled funds whereby the firm charges clients 25 bps for investment management with an extra performance fee charged on top of the 25 bps for alpha. In this way, the firm gets paid more when clients receive investment returns above preset benchmarks. The firm caps referral fees at 1% and the client fees are capped at 1.25% Were this firm to have to cap the fees it pays to referral agents at 25% of fees received from the client, the referral agent would only be able get 6 bps. This is not competitive and would disadvantage the portfolio manager that has set up a fee structure that rewards better return on investments.

We do not believe that the CSA intends to hamper these types of arrangements through the imposition of a cap. We believe bad behavior can be adequately addressed through different means that do not seek to regulate commercial terms.

Far fewer referrals ought to be prohibited than the proposed amendments would capture

In the course of extensive consultation with member firms, PMAC has gathered information on the wide variety of referral arrangements in existence – both within our membership and those we understand exist as a result of other conversations and the findings communicated by the CSA - as well as their impact on investors.

We believe that the arrangements set out in Appendix A serve to address many of the concerns of the CSA set out in the Consultation, such as the advice gap and information asymmetry, investors not receiving the value or returns they could reasonably expect from investing, and/or clients not getting the outcomes that the regulatory system is designed to provide.

It is also our view that these arrangements address many of the OSC's anticipated benefits of implementing the Client Focused Reforms, namely: to deliver more specific and more useful advice for clients; facilitate better engagement between clients and registrants; manage portfolios with better diversification, lower costs and higher risk-adjusted returns over time; increase the probability that clients will reach their investing and savings goals; allow registrants the flexibility within the new framework to re-evaluate business models and business practices to find those that best meet their circumstances; and to make it easier for new entrants and less well-known registrants to compete in the market.

PMAC's preliminary proposal on alternative ways to meet the CSA's policy goals with respect to referral arrangements is set out below. We view heightened transparency and monitoring of registrant conduct to be a more balanced way to address the issue. We hope that these proposals will form the basis for future stakeholder discussions, as we believe that the current proposals go too far and, as a result are unworkable, and, ultimately, may not be in the best interests of investors or the capital markets.

PMAC supports the CSA's efforts to prohibit the following types of referral arrangements and behaviours:

- Referrals with referral agents who have been suspended or barred from registration – either with the CSA or with other regulatory bodies;

- Referrals with referral agents who have surrendered their registration with all members of the CSA with whom they were registered within the past 24 months[3];

- And, though they are already currently prohibited, we reiterate for greater certainty that the prohibition on referrals where the non-registrant performs any registerable activity must continue.

PMAC believes that for portfolio managers, other than in the instances set out above, referral arrangements should continue to be permitted as they currently are under NI 31-103, subject to the following enhanced obligations:

- The portfolio manager must adhere to the existing requirements for referral arrangements set out in NI 31-103.

- Enhancing the existing requirement in Section 13.9, prior to entering into a contract with a referral agent – whether registered or not – the portfolio manager must undertake reasonable due diligence to confirm that the referral agent's registration or membership with any regulatory or self-regulatory body (if applicable) is in good standing and that the referral agent has not been subject to termination, suspension, or disciplinary action from any applicable regulator or governing body (if applicable). This diligence must be documented by the portfolio manager. To this end, we would welcome the establishment of a centralized disciplinary database, covering both registrants and non-registrants. The SEC implemented an additional investor protection search tool earlier this year, SEC Action Lookup for Individuals, or SALI, which is not limited only to registered professionals. We believe that such a centralized repository would benefit investors and industry participants alike.

[3] We believe there will need to be certain exceptions to this prohibition. For instance, in the case where a registered individual wishes to sell their book of business, or where a registered individual is let go from her firm through no fault of her own, it may be reasonable to allow such an individual to provide referrals. Such exceptions could be subject to other controls for discussion in the next round of consultation on this matter.

- On an annual basis, the portfolio manager must reconfirm with the referral agent that there have been no changes to the referral agent's qualifications or good standing (if applicable); and that the terms of the referral agreement are being adhered to, including reconfirmation of the fact that the referral agent is not engaging in any registerable activity.

- On an annual basis, the firm's Chief Compliance Officer must include in his or her report to the board of directors a section confirming review of the firm's referral arrangements and highlight any red flags or deficiencies and how such issues were resolved.

- In terms of transparency and disclosure, we believe an important distinction can be drawn for clients between where a referral agent provides ongoing services and where they do not.

- Enhancing the requirement in Section 13.10 of NI 31-103, after disclosing the referral arrangement to the client in the current manner prescribed, the portfolio manager must receive consent from the client prior to paying the referral (or service fee) to the referral agent for the first time.

- At least annually, the portfolio manager must report the referral (or service) fee separately from the investment management and other fees, alongside the name of the referral agent or service provider; and

- For an arrangement where there are no ongoing or intermittent services provided to the client by the referral agent, the referral arrangement must not result in the investor paying materially more to access the portfolio manager than the client would have otherwise paid to access the portfolio manager directly.

PMAC believes that these amendments would appropriately enhance the referral arrangement requirements to bolster diligence and portfolio manager responsibility, increase investor awareness of fees and of the services (if any), being provided by referral parties. Importantly, we believe that these amendments would provide the CSA with increased insight to effectively audit portfolio managers' referral arrangements.

Were the CSA to find an arrangement that is not in accordance with NI 31-103 for any reason, the CSA would have increased visibility into the nature of the relationship and where the deficiencies are. Moreover, this transparency would assist the CSA's enforcement teams in addressing issues of rogue actors providing registerable advice without the appropriate registration – an offence within the jurisdiction of the CSA to address. We ask the CSA to publish additional guidance as to what constitutes registerable activity to provide clarity to stakeholders and improve compliance.

We encourage all members of the CSA to review Appendices A and B in conjunction with reading this section, as we believe they provide critical context regarding referral arrangements.

Other conflicts of interest

We request that non-individual permitted clients, including their managed accounts, be carved out of the conflict of interest requirements, other than with respect to certain disclosure. We also believe that the conflicts of interest management provisions with respect to proprietary-only firms should not apply to non-individual permitted clients and their managed accounts.

PMAC supports measures that result in investors receiving meaningful disclosure with respect to conflicts of interest, both at account opening, annually, and proximate to new conflict-creating activity. We view enhanced understanding and transparency as important improvements for the benefit of industry and investors.

PMAC has several observations and some concerns, however, about certain aspects of the conflicts of interest proposals, fearing that several of these may result in additional boilerplate and additional cost and could threaten to stifle innovation.

Materiality

Members feel that the requirement to identify all existing and reasonably foreseeable conflicts of interest in a timely way, without being able to focus on only those conflicts that are or may be material, is unworkable. Throughout securities instruments, materiality is used as a trigger for disclosure and other measures. In particular, we note that National Instrument 81-107 – *Independent Review Committee for Investment Funds (***NI 81-107***)* uses a "reasonable person" test to determine conflicts of interest and that NI 81-107 is not intended to capture "inconsequential matters".

We believe that the scope of all existing and reasonably foreseeable conflicts may be too broad. We are also concerned about statement in the Companion Policy about registrants needing to take proactive steps to *anticipate* reasonably foreseeable conflicts. These requirements could cause undue and unwarranted analysis and documentation when the focus should properly be on material conflicts – existing and reasonably foreseeable – as determined by the portfolio manager exercising his or her professional judgement. PMAC also notes that the SEC's recent proposals on conflicts of interest included a materiality qualifier.

Proprietary products

Members view as unnecessary and cost-prohibitive the requirement that, in determining how to address conflicts of interests arising from proprietary products, firms ought to consider obtaining independent advice, or an independent evaluation of the effectiveness of the firm's policies and procedures. We view the assessment of the firm's policies and procedures as the responsibility of highly qualified management and subject to regulatory review.

The proposed conflicts of interest requirements would require registrants to demonstrate that they are addressing conflicts in the best interest of the client and the Companion Policy states:

> It is a conflict of interest for a registered firm to trade in, or recommend, proprietary products. Such firms must be able to demonstrate that they are addressing this conflict in the best interest of its clients.

Additionally, with respect to proprietary product disclosure, the Companion Policy states that in such instances "The firm must also disclose how they are addressing this conflict in the best interest of their clients." We do not believe that pooled funds are *prima facie* conflicts. Instead, we believe that clients can understand disclosure about a firm's securities and its business model (i.e.: proprietary-only firms or otherwise).

PMAC views the propriety product conflict issue as one that is more applicable to dealers than portfolio managers. PMAC does not believe that the use of pooled funds gives rise to the same types of potential conflicts of interest as the use of other proprietary products. We believe that pooled funds are useful vehicles that allow investors access to different securities at a lower cost than might otherwise be available. To impose prescriptive conflict of interest requirements on pooled funds could increase regulatory burden with no corresponding increase in investor protection. It may also lead portfolio managers to offer clients model portfolios rather than pooled funds to accomplish the same goals, since model portfolios are not subject to the proprietary product conflict rules. In certain instances, the use of model portfolios could be less desirable from an administrative standpoint and access to model portfolios is likely to require higher minimum investment amounts than pooled funds.

With respect to a portfolio manager offering proprietary products, if the firm has satisfied the KYC requirements and conducted a KYP analysis, members wonder what purpose a conflicts analysis would serve (other than the disclosure to the client of the conflict).

Powers of attorney

Section 13.4.4(3) prohibits a registrant from acting under powers of attorney (**POA**) or as a trustee or *otherwise* having control over client assets. There are several scenarios in which portfolio managers should be permitted to act under POAs for the benefit of clients. When onboarding a client to a trading platform, it is common for a portfolio manager to enter into a POA on the client's behalf. Managers of pooled fund trusts are commonly the trustees of those funds. If the fund manager (as exempt market dealer) sells securities of the fund to a client, then the provisions under section 13.4.4(3) would be breached, as the client is a beneficiary of the trust (the fund) where the manager is the trustee. We do not believe that appointing an external trustee would be beneficial to investors.

Similarly, it is common industry practice for subscription agreements for limited partnership funds to require a client to grant a POA to the fund manager or general partner to make certain amendments to the partnership agreements, and to act on behalf of the partnership. If the fund managers sold securities of the funds to a client, a similar breach of section 13.4.4(3) would occur. However, unlike pooled funds, there is no fix for a limited partnership. We do not believe that the intent of these proposals is to prohibit these types of structures or relationships and we request that CSA amend these sections accordingly.

Borrowing

We also believe the drafting of Section 13.4.4 carries unintended consequences with respect to borrowing. This section provides that, with limited exceptions and unless certain conditions are met, there is a prohibition on registrants borrowing money, arranging guarantees, or loaning money or securities, providing guarantees or extending credit, or providing margin or any other asset to a client. The prohibition on a client making a loan to a registrant can be read as preventing firm owners that are also clients of the firm from shoring up the firm's capital. The provision, as written, would make it virtually impossible to address a working capital deficiency via a loan within 2 days as required by Section 12.1(2).

Additionally, Section 13.4.4(2) would prohibit a registrant firm from lending money to staff who are also clients as part of an employee benefits program, such as through a housing loan. PMAC also queries whether these sections are intended to prohibit funds or portfolios lending securities.

We further believe that Section 13.4.4(2)(b) is too narrowly drafted in two respects. Firstly, it provides an exception for investment funds and there is no rationale as to why the exemption should be limited to investment funds only. Secondly, the purposes of borrowing are too limited as we believe they should include settlement of portfolio transactions.

Security ownership

PMAC requests clarity that disclosure of a conflict of interest by a portfolio manager recommending a security the portfolio manager owns should not be required on a transactional basis for managed accounts and for proprietary/related issuer products if this conflict has already been disclosed at account opening.

Compensation

Members have requested greater clarity on whether the comment in the Companion Policy requiring disclosure of "any commissions or other compensation that they will be receiving in respect of the transaction" means that the advising or associate advising representative is required

to disclose to the client his or her compensation received from the firm or whether this requirement was intended to capture something different. One suggestion would be to only require the documentation of compensation that gives rise to a conflict of interest.

5. Disclosure and Holding Out

Enhanced Disclosure

Generally, with respect to enhanced disclosure, PMAC urges the CSA to engage their in-house behavioural economics expertise to determine whether more disclosure will truly help address market and investor protection concerns for private clients. Recent reports from the OSC's Office of the Investor identify innovative prompts, carefully timed, selected information dissemination, engagement and education – in lieu of traditional long-form disclosure – as the most effective ways to encourage people to save for retirement or to encourage millennials to invest in Canada's capital markets.

PMAC appreciates that alternatives to disclosure are hard to find, but we believe that we are at a crossroads where the CSA has committed to significant change, at significant cost. We therefore urge the study and development of the most effective ways to intelligibly convey information to clients while promoting the conversations and engagement that would assist investors in meeting their goals. Certain of the proposed enhanced client disclosure would create additional cost, and even more paper for investors to review and comprehend, without any corresponding proof that increased disclosure results in increased comprehension and better outcomes.

Prospective Investor Disclosure

PMAC is concerned that the proposed requirement to provide disclosure to prospective clients may be unworkable and not in the best interest of clients without an accompanying prospective client meeting.

Firms can offer a wide variety of securities or a niche offering and, without having conducted a robust KYC and suitability analysis, it is reasonable that portfolio managers would neither be able to speak to the suitability of their offering, nor to the cost of hiring the portfolio manager. Discretionary management is a complex and multi-faceted profession. It is not one that lends itself to an un-nuanced representation of securities, costs, philosophy, and outcomes.

For instance, many portfolio managers offer a fee schedule that is based on a clients' assets under management and/or which provides a sliding scale discount based on various factors. For example, affiliated entities (or householding of accounts) may aggregate assets for fee purposes and clients may require additional available services that would cause fees to vary.

Additionally, certain firms have different fee scales for accounts as opposed to for pooled funds. Some firms have a fee scale based on performance fees and, as such, fees for many firms could be too complex to reasonably summarize for every client. We also note that there is a fee fairness obligation for clients. To ask a firm to disclose fees to a client about whom the firm knows nothing, could be misleading and inaccurate.

One member firm that is dually registered with the SEC noted that requiring this disclosure would require the firm to maintain two, separate firm websites – one for the US registrant and one for the Canadian – to avoid investor confusion and to avoid offending SEC rules with respect to discussing funds without triggering the general solicitation prohibition.

We do not believe that the investor and market benefits of requiring this disclosure outweigh the costs or the potential for misleading or inaccurate information that could be avoided through a conversation with the prospective client and the portfolio manager.

PMAC also requests that the exemption under section 14.1.2(2) be broadened to include products and services that are sold to directors, officers, or employees of a registrant or its affiliates. Often permitted clients seek assurances that the fund managers or portfolio managers or their parent company or affiliates' directors, officers and employees are invested in the fund. We do not believe that investments by these individuals who have intimate knowledge of the funds should require the fund to make the public disclosures listed in section 14.1.2(1). This exemption would be in line with the family friends and close business associates prospectus exemption under NI 45-106 where the assumption is that those closely connected to an issuer or fund have sufficient knowledge to make an informed decision.

Additionally, should the CSA ultimately require this disclosure to be made, PMAC seeks confirmation that the disclosure can be made free, upon request via phone or email, instead of being made publicly available, as this would present many contextual issues and pose serious competitive concerns.

Holding out and misleading communication

PMAC is supportive of these efforts and believes that clear and accurate communication – whether through titles or holding out – is an important and basic component of investor protection which fosters confidence in the industry and the Canadian capital markets.

Titles

PMAC supports measures that clarify which investment management choices are available to the investing public. We believe the CSA's initiative to reform titles and to replace the use of "advisor" for individuals who are not registered advisers can have a positive investor impact, provided that it is accompanied by corresponding education regarding the changes and their significance.

In order to fully achieve clarity on this point, we believe that both "advisor" and "adviser" should be prohibited by those who are not registered advisers, since investors will not (and should not) pay attention to which vowel is being used to denote a registration category.

Since the CSA has determined that its approach to titling reform will not be principles-based, PMAC believes that registered advisers who are client-facing should be called "Investment Counsellors"; registered advisers who only select securities and those who select securities and are client facing should be called "Portfolio Managers" and associate advising representatives should have the same titles with the addition of "associate" beforehand.

In conjunction with the CSA's review of titles and designations, we believe there should be an emphasis on the corresponding duty of care each registrant owes their client. The CSA should seize this opportunity to provide the investing public with important information on the services provided by different registrants.

6. Training

For advisers, we do not believe it is necessary to require that training be in writing and periodically tested. This is because of the existing proficiency and ongoing educational requirements that advising and associate advising representatives are subject to. We believe that giving firms the ability to creatively and effectively train their employees in ways which may not be documented in writing, provides a more effective outcome.

For instance, many portfolio management firms facilitate open discussions on case studies with their registered individuals (all of whom, it is important to remember, are subject to the ongoing training requirements of their CFA Charter or CIM designation). Others provide training through role play and through formal and informal meetings.

PMAC requests that the CSA explicitly acknowledge that investment committee meetings held by portfolio managers or internal analyst reports constituting training for advisers can fulfill the firm's obligation to provide training under Section 3.4.1. In the absence of this clarification, there are concerns that persons outside the portfolio management function would need to train the portfolio managers, which is impractical, given the advisers' proficiency and RIME. Were the training to be required on a security by security basis, this could be extremely onerous given that most pooled funds or model portfolios hold at least 50-100 securities.

7. Transition

Members anticipate significant compliance, systems and, in some cases, personnel enhancements would be required to comply with the proposed Client Focused Reforms and believe that a transition period of, at a minimum, three (3) years, should be provided. The clock should not start to run on the transition period until such time as the accompanying Self-Regulatory Organization rules are finalized.

8. Other: Imposing a statutory fiduciary duty when a client grants discretionary authority

PMAC supports the introduction of a nationally harmonized statutory fiduciary duty in securities legislation for all registrants managing a client's investment portfolio through discretionary authority granted by the client.

We appreciate that this particular work stream has been delayed as a result of it being beyond the direct scope of the CSA's jurisdiction. However, in the meantime, we ask that the CSA please provide a restatement of the fiduciary duty, as discussed elsewhere in our submission.

To the extent possible, however, we recommend that the CSA jurisdictions that will be adopting a statutory fiduciary duty in their securities legislation adopt the language in Subsection 75.2(2) of the *Securities Act* (Alberta) for consistency. Investors in each province and territory should have the same protections and remedies afforded to them, regardless of the registration category or regulator of their investment adviser. For portfolio managers registered with the CSA, the proposed statutory fiduciary duty will be of little impact as they are already fiduciaries. However, the imposition of this statutory duty in securities legislation nation-wide sends an important message of consistency and underscores the already existent, overarching fiduciary duty of portfolio managers.

3. Concluding Comments

We ask the CSA to consider the many ways in which portfolio managers as individuals and firms differ from other registrants and to keep this fundamental distinction in mind when revisiting the appropriate scope and application of the Client Focused Reforms. We also ask the CSA to keep in mind the nature of international markets and the need to preserve the domestic and international competitiveness of firms, as well as investor choice. We also caution of the potential cooling effect these reforms could have on the competitiveness of the Canadian markets without an exemption for non-individual permitted clients.

While our members are always striving to improve their relationship with and financial success for clients, we believe several of the Client Focused Reforms threaten to heighten cost and complexity, all without benefitting investors who are already very well served by their portfolio managers.

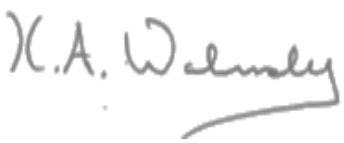
PMAC would like to once again commend the CSA's success in arriving at one set of nationally harmonized proposals which are of utmost importance and benefit to all stakeholders. We extend

our thanks and appreciation to each member of the CSA for the important work that resulted in this outcome.

Lastly, PMAC values the consultation process and the opportunity to engage in this critical aspect of regulatory policy making. Please do not hesitate to reach out to PMAC for any clarification or follow-up prompted by our submission. We would be delighted to elaborate on any point or, to the extent possible, to provide you with more tailored member feedback on specific issues.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



Katie Walmsley
President
Portfolio Management Association of Canada

Margaret Gunawan
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APPENDIX A
Additional Information on Referral Arrangements

Beneficial arrangements

In speaking with members, PMAC has identified a number of referral arrangements that, provided they are done in compliance with NI 31-103 and/or would be subject to PMAC's proposed enhancements to referral arrangements set out in the body of our letter at page 25, ought to be considered by the CSA to be in the best interest of investors. We request that the CSA read Appendices A and B in conjunction with our proposed enhancements and prohibitions for referral arrangements, as those elements form an important backdrop in mitigating any investor and market protection and regulatory oversight concerns.

While it would not be possible to meaningfully address the full range of beneficial arrangements in this submission, we have outlined what we believe to be the most prevalent of such arrangements below.

We believe that our proposed enhancements and prohibitions on referral arrangements are sufficiently principles-based and broad so as to enable a wide variety of beneficial arrangements while simultaneously limiting those that cause regulatory and/or public policy concern.

Members view the proposed referral arrangement rules as limiting the availability of shared client service models that currently exist between portfolio managers and non-registrants. We view shared client service arrangements as being beneficial to investors and particularly responsive to the variety of complex financial services Canadians require. For instance, these arrangements exist with financial or estate planners, tax or probate lawyers, accountants, insurance agents, etc. It is PMAC's view that the industry knowledge and networks created by these arrangements can assist investors.

An example of such an arrangement, which PMAC refers to as a "shared client service arrangement", is as follows: Portfolio managers have entered into arrangements with accounting firms whereby the accounting firm refers appropriate clients to one or more portfolio managers. The portfolio manager collects the fee for the accountant's services from the client and passes it along to the accountant. The investor does not pay more to access the services of the portfolio manager through the referral from the accountant than the investor would otherwise pay. Importantly, the accountant continues to provide tax and accounting advice to the client. The accountant may be present during client meetings with the portfolio manager (with consent of the client), for the purpose of sharing information and helping the client to appropriately assess the tax consequences of certain dispositions or other transactions. We view this as providing enhanced services and expertise to a client.

In the online space, we see referrals of lower-wealth clients to an online portfolio manager being made by financial planners. Again, the investor does not pay more to access the portfolio manager through the referral than she would have had she gone directly to the online adviser. Whether or not the financial planner continues to provide ongoing services to the client – and in many cases they do – we believe this is an example of "right channeling" investors to appropriate registrants. For lower-wealth clients, this right channeling may be particularly beneficial.

In many scenarios, but, particularly in rural Canada, we see investors with a relationship to a financial planner being referred to a portfolio manager. We view these arrangements as important ways to preserve investor choice and to enable independent firms to compete with larger integrated institutions. In the case of rural investors, the referral to an independent portfolio manager may be the only way the investor would have access to a portfolio manager.

PMAC also sees value in referral arrangements where a non-registrant or registrant "right channels" a client to a portfolio manager and provides no ongoing service to the investor. We view this as a way to ensure investors are receiving investment management services that are suited to their needs and situation (provided that the fee received by the referral agent and the length of time for which that fee is received is reasonable and transparently disclosed to the client on an ongoing basis).

All of these scenarios should be viewed by the CSA through the lens of the overarching fiduciary duty owed by the portfolio manager to her client, through the existing requirements under NI 31-103, and through the current rules in NI 31-103 being expanded on by PMAC's proposed prohibitions and enhancements.

APPENDIX B
Responses to OSC Annex E comments on referral arrangements

Responses to referral arrangement comments from the OSC in Annex E

PMAC appreciates the concern that the CSA and, in particular, the OSC, has raised with respect to certain referral arrangements. We wish to work collaboratively to draw more appropriate boundaries around prohibited referrals as opposed to disallowing a wide sphere of referrals.

For this reason, we believe it is important to respond to several comments in Annex E on this point.

With respect to not allowing the payment of referral fees to non-registrants, the OSC comments:

> There is concern that referral fee payments provide an incentive for registered individuals to give up their registration. There is potential regulatory arbitrage concern created when registered individuals can generate similar levels of income without incurring the added oversight and cost of being registered. Remaining players in the system all pay higher costs as more registrants give up their registration and investor protection suffers as more of the advice and relationship chain is held outside of the purview of regulators and compliance officers.

PMAC's suggested enhancements regarding referral arrangements would prevent portfolio managers from engaging individuals who have recently given up their registration. We believe that, properly vetted and overseen, referral arrangements with non-registrants do not threaten investor protection. Furthermore, the regulated party – the portfolio manager – is accountable to the CSA for breaches or deficiencies of the referral arrangement provisions and, in worst case scenarios, the CSA does have jurisdiction to pursue individuals violating securities laws by engaging in registerable activities without registration.

PMAC's suggested enhancements would provide the CSA with greater insight and auditability into these arrangements.

> Second, and related to the first issue, we have noted several instances where non-registrants are receiving the bulk of the revenue generated through registerable activity. In some cases, registrants are reporting that greater than 80% of the revenue generated through registerable activities such as portfolio management is being handed over to non-registrants as referral fee payments. As a principle, there is a belief that if an individual is receiving the bulk of the revenues from the registerable activity then that individual should be registered.

Fee caps, as currently proposed, are arbitrary and create an unlevel playing field between registrants and non-registrants, as well as between lower margin registrants and those who charge higher fees for investment management. We believe the CSA can better guard against registerable activity being performed by non-registrants through putting an increased onus on registrants to review and affirm that no such conduct is being undertaken. We also believe the CSA has an opportunity to clarify for stakeholders where the line is between registerable and non-registerable activity to provide a clearer goal post against which parties can assess the compliance of their conduct.

> Third, there are market power concerns regarding the ability of referring agents to extract referral fees from registrants. Certain registrants may not want to pay the referral fee or current referral fee levels but are being forced to under the current system.

PMAC believes that the fees payable by portfolio managers is a matter of professional judgement and is more properly regarded as a commercial term negotiated between to contracting parties. As long as the portfolio manager – who is subject to both a fiduciary duty and the requirements under NI 31-103 – is compliant with the law, fees should be able to be negotiated in a manner that each firm deems appropriate.

> These proposals may have unintended consequences however in that both referral arrangements that leave the client worse off and referral arrangements that benefit the client will be impacted. […] Much depends on motivation for the payment and acceptance of the referral. For example, if as a result of the payment of a referral fee, clients are "right channeled" to registrants that are more likely to meet their needs, then the payment of the referral fee can be beneficial to the clients' interest. In such a situation, the proposed prohibitions may increase our concerns around the expectations gap as clients will be expecting too much from the wrong registrant. If the payment of a referral fee is conflict-creating, such as when it causes the referrer to not adequately vet the referree or consider other potential referrees, or moves a client to a channel that is better for the profitability of a parent company of two parties to a referral arrangement, then these proposals can improve client outcomes and potentially result in better channel/registrant fit for the client. There is a balance underlying the proposed change to the referral arrangements.

PMAC respectfully disagrees that the baby must be thrown out with the bath water here. PMAC's suggestions place an increased emphasis on the portfolio manager to vet and oversee the referral arrangement. We also respectfully disagree that a referral agent would be motivated to refer a client to a registrant under the CSA, under the proposed amendments. We believe that referrals would be made to individuals wholly outside of the ambit of the CSA. We do not believe that the investor harm would be expecting too much of the wrong registrant, but rather, that the greater and more likely investor harm would be failing to be referred to a portfolio manager when that client could benefit the most from portfolio managers' discretionary management, professionalism and fiduciary duty. For example, we believe that certain investors with potentially less access to portfolio managers, such as investors in rural Canada would no longer be referred to portfolio managers if financial planners are no longer permitted to be paid referral fees from portfolio managers. We see this as a serious investor choice and protection issue that warrants further exploration.

> For PMs that service retail clients to some degree (60% of PM firms and 9% of PM assets), a large share of their referral arrangements are with non-registered entities such as financial planners. These firms will likely need to turn to alternatives such as traditional advertising to attract clients. However, it is not clear where the clients being referred to PMs by financial planners today would go in the future. Some referring agents may decide to become registered and bring over their clients in order to keep existing relationships and revenue lines intact. Others may decide to refer clients to alternative financial service providers instead.

PMAC has concerns about the views expressed above. We strongly believe that clients referred to alternative financial services providers would not be as well served, at least from a duty of care standpoint. This also raises questions as to whether Canadians could end up paying higher costs and receiving a lower standard of care.

Additionally, this statement ignores the very real barriers to registration for many financial planners, including but not limited to: many will not perform enough registerable activity to warrant registration; many will neither have nor want to acquire the proficiency to become registered when they have a financial planning business to run; and the costs of being a registrant, especially in light of the Client Focused Reforms, can be prohibitive.

Further, it is our view that suggesting that traditional advertising can act as a substitute to referrals from trusted sources, such as financial planners, belies the nature of the client-portfolio manager relationship. It is one of trust. Importantly, according to the CFA's Next Generation of Trust Report, almost 1 in 5 people consider the recommendation of someone they trust to be the most important attribute when hiring a financial adviser / asset manager; accordingly making recommendations and referrals from trusted sources a very powerful tool that we do not believe traditional advertising can compete with. US and UK studies of the cost to robo-advisers of acquiring a new client using traditional advertising range from between circa CND$500 in the US to CND$600 in the UK. Considering that some portfolio management firms do not have account minimums, these client acquisition costs would take a number of assets under management and it would take a number of years to earn back the advertising spend. For example, an online firm with a client account of $50,000 would take about 3 years to earn back the cost of the advertising to

acquire that client. We believe this could lead to a greater advice gap if portfolio managers no longer feel they are able to effectively service these lower-value accounts. We urge the CSA not to adopt broad-sweeping rules that threaten to exacerbate the advice gap for Canadians with more modest account sizes when a more tailored approach would better serve all stakeholders.

> Ultimately, we anticipate that investors will benefit from these proposals. A larger share of individuals will remain registered and subject to oversight, fees paid to registrants will be more likely to align with the services each registrant is providing and it is more likely that referrals will be made in the best interest of the client.

It is our view that PMAC's proposed enhancements to referral arrangements would address concerns about registrants giving up their registration and with respect to enhanced oversight. We also wish to reiterate that, while this may not be the case for all registrants, portfolio managers are already bound by a fiduciary duty of care to their clients and, as such, have always and will continue to be required to enter into referral arrangements in the best interests of their clients.

We believe that the impact to investors and firms alike of the enactment of the prohibition on referral arrangements will be material and deleterious and ask the OSC and its CSA colleagues to continue this important regulatory initiative with the benefit of additional data and stakeholder input.