CAPITAL GROUP℠

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BY ELECTRONIC MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

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, Yukon Territory
Registrar Whaof Securities, Northwest Territories
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

Re: CSA Proposed Amendments to National Instrument 31-103: Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

Capital International Asset Management (Canada), Inc. ("CIAM" or "Capital Group") is writing in response to the CSA's proposed amendments to National Instrument 31-103 (the "Rule") and to the corresponding Companion Policy to the Rule (the "CP") (together, the "Proposals"), which are intended to better align registrant conduct with the interests of their clients and to improve client outcomes. We commend the CSA in its continuing efforts to enhance the advisor-client relationship to deliver better outcomes for investors. In this regard, we are pleased with some of the provisions in the Proposals which, we believe, will strengthen the interests of investors and improve communication between advisors and their clients.

CIAM is registered in the categories of investment fund manager, portfolio manager and exempt market dealer. Our funds are primarily distributed through third party dealers; however, we also distribute our funds to permitted clients through our exempt market dealer registration.

As a private firm with an independent charter, we are focused on doing what's right for investors over the long term. As part of a large global organization, we are able to pass along economies of scale to our investors through reduced fees, which we have done since our inception. Over the past two years, we have simplified our offerings to help further address economic benefits for investors.

Being part of a global organization, Capital Group benefits from experiences and insights from these markets and such discussions provide relevant context for the comments below.

We support the submission made by the Investment Funds Institute of Canada on these Proposals and have reflected our additional comments below.

Changing the focus to "client outcomes" versus "inputs"

There are two critically important areas for comment; if enacted as drafted, both have a high probability of material, adverse, unintended consequences for investors.

First, the over-emphasis on cost as the dominant determinant input when selecting investments may lead to sub-optimal outcomes for investors. To reduce regulatory risk, firms and advisors may interpret the Proposals as suggesting that the lowest-cost option is the only critical criterion when selecting investments. While cost is an important factor to consider, it alone does not constitute a sufficient basis for choice.

A few active managers have produced outcomes materially better than the lowest-cost alternative; these differences have led to substantially better outcomes for clients after costs. Morningstar issues stewardship grades, which consider a multiplicity of factors to evaluate how fund companies' interests are aligned with those of investors.

The factors considered by Morningstar in this exercise include: "(1) the quality of the fund companies' corporate culture; (2) the extent that fund managers' financial incentives align with fundholders' long term interests; (3) the competitiveness of fees; and (4) regulatory history." We believe it is important to consider factors other than costs when considering product alternatives and urge the CSA to clarify their expectations to specifically reference these other factors in the Rule.

Secondly, as described below, the likely outcome of the Know Your Product requirements for firms and advisors will be to narrow shelves, reducing choice for investors and competition which drives better services and lower fees. This is directly counter to the CSA's intent and is already evident in the marketplace.

Other specific comments regarding some of the client focused reforms and potential impacts are noted below.

Conflicts of Interest

We support the CSA's position to infuse a best interest standard in the management of conflicts of interest. In order for firms to practically identify and manage conflicts in clients' best interests, we believe it is imperative that the focus should be on the 'materiality' of the conflict. The Rule requires registered firms and individuals to identify conflicts that are "reasonably foreseeable" and the CP explicitly states that this obligation extends beyond identifying only material conflicts which is in the existing set of rules. The Proposals do not describe the types of conflicts that may be considered as being 'reasonably foreseeable' and we question how firms are expected to identify and document such types of conflicts in order to comply with this new requirement.

In addition, requiring all conflicts to be addressed (vs. material ones), will not only pose challenges for registrant firms and individuals, it will undermine the intended purpose of this requirement for investors. Disclosure of all identified conflicts may suggest to investors that all conflicts have been disclosed and that they are receiving conflict-free services which may inhibit them from conducting their own due diligence on registered firms and individuals. In addition, requiring disclosure of a 'laundry list' of potential conflicts may distract investors as opposed to providing them with direct and meaningful disclosure of material conflicts. When considering conflict policies, we suggest that the CSA consider the approach proposed by the U.S. Investment Company Institute ("ICI") in their recent comment letter ("ICI comment letter") to the SEC dated August 7, 2018 in response to the SEC's proposals on the standards of conduct for investment professionals. The ICI comment letter states that such policies should "(i) identify and disclose material conflicts of interest associated with a recommendation, and (ii) mitigate, or eliminate, those material conflicts of interest associated with the recommendation that create a financial incentive for the associated person of the broker-dealer to put the associated person's interests ahead of the retail customer's interests."

Compensation-related conflicts are inherent in clients' relationships with registrants. Increased expectations to identify and respond to all conflicts of interest will require registered firms and registered individuals to proactively monitor all activities that may

be perceived as conflicts rather than focusing on specific clients' accounts and transactions that may give rise to material conflicts which need to be addressed. We believe that registered firms and individuals need to identify, disclose and mitigate or avoid, as the case may be, material conflicts of interest in consideration of client's best interests.

Under the current Proposals, registered firms will also need to revise existing conflict of interest policies and disclosures, implement new internal controls, and train all staff to enable them to effectively identify, address and document all conflicts as they arise. This is inconsistent with recent guidance published by the Ontario Securities Commission in their OSC Annual Summary Report dated Aug. 23/18 where they state that firms need to provide training on "material" conflicts of interest; we believe a materiality standard when considering conflicts is a reasonable and achievable approach in terms of investor outcomes.

With respect to proprietary products, the CP references that firms who only trade in proprietary products need to do periodic due diligence on comparable non-proprietary products to evaluate competitive alternatives. In addition, the CP requires firms to do an independent evaluation and obtain independent advice on the effectiveness of the firm's policies and procedures to address conflicts. This requirement is onerous for independent firms such as ours and we question the resultant benefit for investors. Through our Exempt Market Dealer ("EMD") registration, we distribute our products to a few permitted client investors who have requested to hold Capital Group investments. Capital Group does not charge for its EMD services, including conducting competitive scans. Not only are these prescriptive requirements not in the Rule, the CP does not specify the CSA's expectations regarding what's considered as 'comparable' or 'independent' for the purposes of conducting such product comparisons and independent evaluations.

For other firms that provide advice and offer both proprietary and non-proprietary products, we believe the competitive evaluation would benefit investors and that a conflicts mitigation regime is appropriate if there are any financial incentives for representatives to recommend proprietary vs. third party products, such as differences in compensation and incentive structures.

Third party compensation is also viewed as a conflict that needs to either be controlled or avoided. While we believe conflicts are inherent in all forms of compensation, there is existing guidance in NI 81-105 which is designed to address third party compensation conflicts regarding trailing commissions which states that the instrument is "intended to remove the conflicts inherent in representatives seeking to achieve specific asset and sales thresholds in order to receive compensation" (81-105CP, s. 5.3(6)). In addition, sections 4.1 and 4.2 of NI 81-105 already address internal dealer incentive practices that may give rise to conflicts. Section 6.1 of the 81-105CP acknowledges that the CSA recognize that "different mutual fund organizations may pay different levels of commissions to dealers and that there is no compelling reason to prevent those differentials from flowing through to the representatives." However, we note that the marketplace has evolved to paying similar embedded compensation across a large majority of similar mutual funds. If disclosure of conflicts related to third party compensation is required to be enhanced, we believe the CSA

needs to revise NI 81-105 sales practices rules, including the application of those rules to products beyond mutual funds (i.e. GICs, segregated funds, non-prospectus funds) in order to ensure a level playing field and mitigate opportunities for regulatory arbitrage.

With respect to the CSA's concerns regarding an 'expectations gap' referencing that "clients often have misplaced reliance on or trust in their registrants" potentially leading to "sub-optimal investment decisions", we believe the existing regulatory regime as it applies to mutual funds is robust and sufficient to appropriately address those who contravene the rules. In addition, we believe that there is some onus on the investor to conduct their own due diligence and validate using abundant information easily accessed via websites and other digital forums. We believe investor education can also be enhanced to address the financial literacy gaps and to help investors benefit from the outcomes that the existing regulatory system is designed to provide.

Know Your Product ("KYP")

We agree with some of the new explicit KYP obligations in the Proposals on registered firms and individuals. We agree that registered firms and individuals need to monitor and assess the securities that are offered and be educated on these securities. The Proposals require firms to compare the "similar" securities available on the market and maintain an offering of securities and services that is consistent with how it holds itself out. Similarly, registered individuals need to have a general understanding of the securities that are recommended including how they compare.

In addition, with respect to product comparisons, pursuant to the CP, registered firms will need to compare securities made available to a "reasonable range of similar investment opportunities" and seem to have a bias towards lower cost products being preferable. What does the CSA consider to be "similar" investments and what are the CSA's expectations regarding factors other than costs that may impact product comparisons? The CSA reference in the Proposals that they anticipate that these new requirements will result in "a higher provisions of lower cost, better performing securities to clients." While lower cost securities are an important input, client goals or outcomes are more important, starting with the objective of the portfolio and the investment. The Proposals are overlooking other critical factors that may also have a significant impact on investor outcomes such as portfolio diversification, returns, distributions, etc. There are several subjective considerations when comparing securities and firms including, but not limited to, the nature and quality of service providers, firm reputation, culture, compensation structure, regulatory history, investment minimums, benefits of consolidating assets at a single firm, etc.

The KYP requirements also require firms to document their "independent analysis" of securities as part of their due diligence process. The CP states that a security cannot be approved by a firm based solely on documents, reports from issuers or related parties including "independent" third parties. The current practice of dealer firms relying on disclosures and documents prepared by third party fund companies would not be acceptable pursuant to these new requirements for independent analysis. We request some clarity about the CSA's expectations regarding an independent analysis

in terms of what documents, analysis, etc. would be acceptable. The self-regulatory organizations allow for the existing practice of dealer firms relying on materials provided by investment fund managers, provided the dealer firm has no reason to question the validity of such documents. The new requirements, as proposed, to conduct an independent analysis would be burdensome and result in additional costs to registrants with no corresponding benefit for investors.

With respect to exemptions, the existing permitted client exemption from certain KYC and suitability requirements of NI 31-103 by way of waivers, are not extended to the KYP requirements in the Proposals. When transacting with permitted clients in our scenario, we question the need to conduct such product comparisons, independent analysis and other due diligence on our own prospectus-qualified mutual funds.

The new KYP requirements will require firms to ensure that their overall security and service offerings are consistent with how firms hold themselves out in order to meet clients' expectations in this regard. We are concerned that these new requirements do not consider the various types of business models that currently exist. As an example, our EMD has a limited footprint as we distribute only our own funds (which are prospectus-qualified) to permitted clients; however, due to the clarifications to NI 31-103 that went into effect at the end of last year, we can only distribute these NI 81-101 funds on a prospectus-exempt basis. Accordingly, instead of providing the simplified prospectus or Fund Facts as the disclosure documents expected by clients, we can only provide our EMD clients alternative forms of disclosure documents such as term sheets. As we are a firm that offers only prospectus-qualified mutual funds, it is confusing for those EMD clients when we cannot provide the prospectus and conventional disclosure documents when we are transacting through our EMD.

Recordkeeping Obligations

The Proposals have expanded recordkeeping obligations requiring firms to document their sales practices, compensation arrangements and other incentive practices. There is considerable guidance provided in the CP in this regard. It is not clear how these obligations interact with requirements in NI 81-105 regarding monetary and non-monetary benefits and incentives. The Proposals reference NI 81-105 in the context of prior comments received supporting amendments to the sales practices rules. If the CSA intends to make consequential rule amendments to NI 81-105, then it should also consider expanding the application of this sales practices rule to other investment products and services, as mentioned above.

Unintended Consequences

The Proposals and, in particular, the CP, either significantly expand on existing requirements or introduce new onerous requirements that are based on a one-size-fits-all approach. We are concerned that this may result in consolidation in the industry and/or narrowing of product shelves based on arbitrary measures chosen by dealer firms, consequently having the effect of reducing choices for investors. We have become aware through industry discussions that certain distribution firms are already limiting their product shelves based on certain asset thresholds. In addition, these new and enhanced requirements may not be required for certain business

models such as EMDs who only have transactional relationships with clients. We suggest that the CSA consider the various business models before imposing some of the new or enhanced requirements in the Proposals.

As described above, we are concerned with how registrant firms will be able to practically comply with and document compliance with some of the new and enhanced requirements. In addition, the guidance in the CP is quite detailed and, in several instances, more prescriptive than the Rule requirements. It is unclear whether registrant firms are expected to implement compliance controls and systems based on the prescriptive CP guidance or based on the Rule. In future compliance reviews, how will the CSA enforce compliance with the Rule when the guidance in the CP contains more details including the CSA's expectations?

In the introduction to the Proposals, the CSA acknowledges that they have sought to make the Proposals "scalable to fit registrants' different operating models, and to preserve the technology-neutral stance of the Instrument". Per the comments made above, we believe the Proposals continue to follow a one-size-fits-all approach and fails to recognize and differentiate between the various business models and scenarios.

In the Regulatory Impact Analysis of the Ontario Securities Commission contained in Annex E of the Proposals, we agree that the CSA Proposals will impose "significant" transition costs; however, we disagree that such costs will be "one-time" only costs that "will impose only marginally higher on-going costs of compliance". Some of the new and significantly enhanced requirements in the Proposals will require firms to demonstrate and document compliance on an ongoing basis. The new KYP requirements will require firms to "justify what is on their product shelf" including approving, monitoring and reassessing product shelves on an ongoing basis. The CSA anticipates that third party service providers (data providers, etc.) will assist registrants in developing compliance controls. While some of these changes will result in one-time costs, the CSA has overlooked the ongoing compliance requirements and oversight required to confirm and document continual compliance with the Proposals.

We urge the CSA to consider the above comments and to do further industry analysis before implementing the Proposals.

Thank you for the opportunity to provide our comments. If you have any questions, please feel free to contact the undersigned.

Yours truly,

CAPITAL INTERNATIONAL ASSET MANAGEMENT
(CANADA), INC.

(signed) "Mark Tiffin"

Mark Tiffin
President