Via email

October 6, 2016

Ontario Securities Commission
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comments@osc.gov.on.ca

and

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Dear Sirs/Mesdames,

Re: Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"), Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("31-103CP"); and National Instrument 33-109 *Registration Information*

This comment letter is being submitted on behalf of the following entities within RBC: RBC Dominion Securities Inc.; RBC Direct Investing Inc.; Royal Mutual Funds Inc.; RBC Global Asset Management Inc.; RBC Phillips, Hager & North Investment Counsel Inc.; and Phillips, Hager & North Investment Funds Ltd. We are writing in response to the Canadian Securities Administrators' ("CSA") request for comment on the proposed amendments to NI 31-103 related to custody, exempt market dealer, client relationship model Phase 2 ("CRM 2") and housekeeping revisions (the "Proposals") published on July 7, 2016 (the "Notice").

Since the implementation of NI 31-103 in 2009, we recognize the substantial efforts and the advancements that the CSA has made in developing a harmonized and streamlined regulatory framework for dealers, advisers and investment fund managers. We are pleased that the CSA has continued to monitor industry developments and has published for comment further amendments which address investor protection issues, provide additional guidance and codification of previously issued orders. That being said, we do have concerns with some of the proposed amendments for which we are seeking additional clarification or guidance. We have outlined below our specific comments.

1. New Proposals Regarding EMD Activities

We would like the CSA to confirm that paragraph 7.1(2)(d) of NI 31-103 would *not* preclude an exempt market dealer (EMD) from trading in securities of an investment fund to exempt clients where the fund is a reporting issuer and can also issue securities via a prospectus to non-exempt clients. In other words, just

because a tranche of securities of an investment fund is prospectus-qualified and thereby distributed to retail investors, an EMD would not be precluded from trading in a separate tranche of securities of the same investment fund in reliance on an exemption from the prospectus requirement (e.g., to an accredited investor). This is how we interpret this provision, and we understand that other legal counsel share this view. Many IFM/PM/EMD registrants rely on their EMD registration to deal directly with accredited investors and other qualified investors to trade in securities of their investment funds (even where there is also a prospectus for retail sales) pursuant to prospectus exemptions. Although Section 8.6(1) of NI 31-103 provides an additional dealer registration exemption that might be relied upon in *some* of these circumstances, this exemption applies only in the managed account context and so would not be helpful in a non-managed account context. We feel strongly that the correct interpretation of paragraph 7.1(2)(d) is as we have stated, but we understand that other industry participants may have been told that this interpretation is not consistent with that of all members of the CSA. We thus respectfully request that the CSA confirm our interpretation that EMDs can continue to rely on their EMD registration to trade investment fund securities to exempt clients (even if it also so happens that securities of that fund are also traded to retail investors via prospectus).

2. Custody Amendments

We are generally supportive of the proposed changes to the custody regime applicable to non-SRO firms which are designed to enhance the protection of client assets by addressing intermediary risk. We appreciate the distinction made between custody arrangements that are "directed or arranged" by registrants and those that are negotiated by a client independently, or inherited as part of a new client relationship. We believe that such flexibility of client choice should be preserved; however, we would appreciate additional guidance in terms of registrants' responsibilities in instances where custody arrangements are purely client driven.

Proposed Section 14.5.2 of 31-103CP includes guidance for investment fund managers in respect of key terms that they should consider when entering into a written custodial agreement on behalf of the investment funds managed by them. We believe this guidance is sufficiently clear and it is not necessary nor desirable for there to be prescribed key terms for custodial agreements in NI 31-103, similar to the requirements found in NI 81-102 and NI 41-101.

Lastly, proposed Section 14.5.2(7)(e) of NI 31-103 states that the Proposals do not apply to customer collateral subject to custodial requirements under National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*. We note, however, that the Proposals do not include any provisions similar to those contained in NI 81-102 Section 6.8(3) related to certain derivatives transactions, NI 81-102 Section 6.8(5) related to securities lending, repurchase and reverse repurchase agreements and NI 81-102 Section 6.8.1 related to short sales. Further, the Proposals do not indicate whether the use of a depository or clearing agency by a qualified custodian would be permitted, as it is in Section 6.5(3) of NI 81-102. We would appreciate clarification that the CSA would view these types of transactions as permitted under the Proposals.

3. Firms Registered in Quebec in the Mutual Fund Dealer Category

We note with concern that the proposed custody amendments would prohibit a firm registered in Quebec, in the mutual fund dealer category, from holding securities and cash in nominee form. The lack of detail provided, particularly whether the involvement of a non-functionally independent custodian, in accordance with proposed section 14.5.2(5), would trigger this restriction, makes the application and impact of this proposal difficult to ascertain; accordingly more clarity is requested on this point. For those mutual fund dealers which operate throughout Canada, the proposal fails to recognize the potential administrative and technological impact to registrants, which the inconsistency in regulation will create. As we have commented previously in respect of other regulatory initiatives, achieving harmonization in the interpretation and implementation of regulatory requirements and administrative processes is critical to ensuring a consistent and efficient framework that protects investors and reduces an unnecessary regulatory burden resulting from multiple sets of rules and standards. Moreover its potentially negative

effect on the ability of clients to transact in an administratively convenient manner has not been addressed. Securities are held in nominee format solely for the purpose of allowing the trading of securities in book format rather than requiring the production of a certificate. The proposed restriction may disadvantage Quebec resident clients for the aforementioned reason or, for example, by potentially reducing the range of product options available where, by virtue of the product type, the dealer is unable to hold the security in nominee format, and is, arguably, not wholly to the benefit of the client.

4. Client Relationship Model Phase 2 Amendments

We recognize that the Proposals seek to make permanent certain temporary relief granted by the CSA in May 2015 to address the following: decisions made by the CSA with regard to more time to implement certain provisions of the CRM 2 amendments; technical issues identified related to the delivery of information required by the 2013 amendment; relief from the requirement to identify securities that may be covered under an investor protection fund; and relief for IIROC and MFDA members from certain 2013 CRM 2 amendments provided that they comply with the corresponding IIROC or MFDA provisions. We support the proposed amendments to incorporate the details of the relief orders within NI 31-103, specifically as it relates to recognizing the exemptions from certain requirements of NI 31-103 for IIROC and MFDA members since the rules of these self-regulatory organizations already address CRM 2 requirements (e.g. delivery of the report on charges and other compensation and investment performance report).

We note the Proposals related to CRM 2 include additional guidance outlining the CSA's expectations related to disclosure of charges and other compensation. Specifically, 31-103CP has been revised to include an expectation that disclosure to clients would include such things as commissions paid by issuers, and bonuses received from affiliated companies. We believe that the CSA should consider a principles based approach to compensation-related conflicts of interest. More specifically, the requirements outlined in Section 13.4 of NI 31-103 and 31-103CP specify that firms take reasonable steps to identify existing material conflicts of interest and material conflicts that the firm reasonably expects to arise between a firm and a client. We believe that the existing obligations that firms have and the policies and procedures they currently have in place to identify and respond to conflicts of interest in an appropriate manner whether through avoidance, control or disclosure are adequate. For example, 31-103CP outlines a requirement that firms ensure that clients are informed about conflicts of interest including when a conflict of interest may affect the service provided.

5. Non-Cash Incentives and Embedded Fee Disclosure

The Notice indicates that the CSA are also seeking comments on whether clients should be made aware of non-cash incentives and embedded fees. The Proposals prescribe that additional disclosure should be included in the annual report to clients related to additional sales incentives. We believe that there is no need to duplicate an existing regime that is appropriately managed within the framework under National Instrument 81-105 *Mutual Fund Sales Practices.* Additionally, as indicated above, firms have an obligation to identify and respond to conflicts of interests. To that end, firms would assess whether a non-cash incentive would give rise to a conflict of interest and manage the conflict accordingly, including through disclosure as appropriate.

RBC is fully supportive of disclosing the embedded fees of financial products, most particularly with respect to mutual funds and ETFs. However, the logistics of such disclosure must be carefully considered. For example, at the most basic level: who should report embedded fees to unit holders, the manufacturing firm, or the distributor advisory firm? And what level of detail will provide meaningful information to unit holders without overwhelming them? We believe that care must be exercised such that disclosure requirements do not create onerous and costly obligations that investors are ultimately harmed by way of limited access or less choice. We would recommend a cross industry working group be formed to assess embedded fee disclosure alternatives and provide recommendations to the CSA.

6. Investment Performance Report – Percentage Return Calculation Method

The proposed guidance indicates that the client's actual personal rate of return should be compared to the client's target rate of return. We note that the client's target rate of return is currently appropriately referenced in the context of financial planning (i.e. the sample Investment Performance Report refers clients *who have a personal financial plan* [emphasis added] to compare the personal rate of return to their target rate of return). We recommend that similar language be added to the proposed guidance for clarity as to when such a comparison of returns should apply.

7. Housekeeping Amendments - Pre-conditions to the use of Form 33-109F7

We appreciate that the CSA has revised the language on the Form 33-109F7 to permit an individual to apply for reinstatement where individuals have obtained other licences since the completion of the Form 33-109F4. As part of the CSA's review of Form 33-109F7, we suggest that the wording of Question 1 of Item 9 in the Form 33-109F7 – *Reinstatement of Registered Individuals and Permitted Individuals* be clarified. The current wording to Question 1, Item 9 of Form 33-109F7 indicates the following:

> "Check the appropriate box to indicate that, since leaving your former sponsoring firm, there has been a change to any information previously submitted to your Form 33-109F4 that are listed below."

As stated in the General Instructions to Form 33-109F7, the pre-conditions to use the Form 33-109F7 are that there have been "no changes" to certain disclosure items other than changes to Item 13.3(a). To clarify this requirement, we believe that the CSA should consider revising the wording to Question 1 of Item 9.

8. Implementation of the Proposal

The securities industry is embracing a number of significant regulatory developments such as the implementation of CRM 2 and Point of Sale Framework for mutual funds. We suggest that the CSA consider appropriate timelines for the implementation of the Proposals specifically as it relates to any changes in disclosure required in the annual reporting to clients.

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We appreciate the opportunity to provide comments and welcome the opportunity to discuss the foregoing with you in further detail. If you have any questions or require further information, please do not hesitate to contact the undersigned.

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