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CSA Notice of consultation

Draft *Regulation to amend Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Draft Amendments to *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

June 21, 2018

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are publishing for a 120-day comment period draft amendments to *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**Regulation 31-103**) and to *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the **Policy Statement**, together the **Regulation**) (the **Proposed Amendments**). We are proposing amendments to the registrant conduct provisions in the Regulation in order to better align the interests of securities advisers, dealers and representatives (**registrants**) with the interests of their clients, to improve outcomes for clients, and to make clearer to clients the nature and the terms of their relationship with registrants. We are also proposing technical, non-substantive consistency changes to the Regulation.

This notice contains the following annex:

- Annex A – Summary of comments on CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward Their Clients* (the **Consultation Paper 33-404**) and responses.

This notice will also be available on the following websites of CSA jurisdictions:

www.lautorite.qc.ca

www.albertasecurities.com
www.bcsc.bc.ca
www.fcnb.ca
nssc.novascotia.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca
www.msc.gov.mb.ca

Substance and purpose

Introduction – Client Focused Reforms

The Proposed Amendments are part of the CSA's harmonized response to concerns we have identified relating to the client-registrant relationship as it stands today. 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 their clients, improving outcomes for clients, and making clearer to clients the nature and the terms of their relationships with registrants.

The CSA, the Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association of Canada (**MFDA**) (together referred to as the **SROs**) are committed to changes at the core of the Proposed Amendments which would require registrants to promote the best interests of clients and put clients' interests first. This is a fundamental change that focuses on the client's interests in the client-registrant relationship.

Under the Proposed Amendments, registrants will be required to:

- address conflicts of interest in the best interest of the client,
- put the client's interest first when making a suitability determination, and
- do more to clarify for clients what they should expect from their registrants.

The Proposed Amendments and the investor protection concerns that they seek to address are discussed in more detail below.

In preparing the Proposed Amendments, we have taken comments from the consultations into consideration. We have sought to make the Proposed Amendments scalable to fit registrants' different operating models, and to preserve the technology-neutral stance of the Regulation. Additional harmonized reforms that the CSA intends to develop at a later stage are discussed below.

The CSA have consulted with the SROs in developing the Proposed Amendments. We encourage all SRO members to provide their comments on the Proposed Amendments. It is our intention that our final amendments will be incorporated into SRO member rules and guidance; therefore, comments from all registrant categories will be beneficial to the rule development process.

Overarching regulatory best interest standard

The Ontario Securities Commission (**OSC**) and the Financial and Consumer Services Commission of New Brunswick (**FCNB**) carried out extensive consultations with stakeholders and the SROs regarding the adoption of an overarching regulatory best interest standard as proposed in the Consultation Paper 33-404. They are not proposing to adopt an overarching standard at this time.

The OSC and FCNB have worked with the CSA to develop a harmonized approach that infuses the client's best interest into the conflicts of interest and suitability reforms. This approach addresses the specific concerns they had in these areas and ensures the interests of the client are paramount.

Additionally, with this harmonized approach, they believe clients will immediately benefit from the reforms, and registrants will have certainty as to the fundamental regulatory obligations they owe to clients.

To the extent they do not see a change in behavior demonstrating that the Proposed Amendments achieve the outcomes they are seeking for investors, they will revisit this approach.

Overview and scope of the Proposed Amendments

We seek to enhance the client-registrant relationship by amending the following provisions in Regulation 31-103, supported with detailed guidance:

- know your client (**KYC**),
- know your product (**KYP**),
- suitability,
- conflicts of interest, and
- relationship disclosure information (**RDI**).

These provisions set out the fundamental obligations of registrants toward their clients and are essential to investor protection. They are designed to work together throughout the client-registrant relationship, as an extension of the duty of registrants to deal fairly, honestly and in good faith with their clients.

The Proposed Amendments relating to conflicts of interest and suitability include these critical provisions: registrants would have to address all existing and reasonably foreseeable conflicts of interest, including conflicts resulting from compensation arrangements and incentive practices, in the best interest of the client, and they would have to put the client's interest first when making suitability determinations.

The Proposed Amendments relating to KYC and KYP are designed to support these critical provisions. They are also intended to provide clarity about our expectations of what information a registrant must collect about a client, and to increase rigour and transparency around the products and services that registrants make available to their clients. Additional enhancements to the suitability determination requirement would also include explicitly requiring registrants to consider certain factors, including costs and their impact, and to require these determinations to be made on a portfolio basis.

In addition to requiring that conflicts of interest be addressed in the best interest of the client, the Proposed Amendments relating to conflicts of interest also include restrictions on referral arrangements and strengthen the prohibitions on misleading marketing and advertising.

The Proposed Amendments relating to RDI provide for expanded disclosure about any restrictions on the products or services a registrant will make available to a client, including when the registrant uses proprietary products, and the impact on a client's investment returns that may result from such restrictions, as well as the potential impact of costs and charges. We are also proposing to introduce a new requirement to make key information publicly available so that potential clients are better able to choose a registrant that is likely to meet their expectations.

Finally, we propose corresponding changes to requirements and guidance concerning the training of representatives and maintenance of policies, procedures, controls and documentation to support the important role of registrants' internal compliance systems.

Other CSA consultations

The CSA coordinated the policy considerations related to the key issues outlined in Consultation Paper 33-404 and CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions*, published on January 10, 2017. As further outlined in *CSA Staff Notice 81-330 Status Report on Consultation on Embedded Commissions and Next Steps* published today, we believe the Proposed Amendments relating to conflicts of interest will allow registrants flexibility in how they address the material conflict of interest presented by embedded commissions in a manner that is in the best interests of clients.

Background

Consultation Process

Regulation 31-103 came into force on September 28, 2009 and introduced a harmonized, streamlined and modernized national registration regime. Since implementation, we have monitored the operation of the Regulation and have engaged in continuing dialogue with stakeholders with a view to further enhancing the regime.

The Proposed Amendments were developed after an extensive consultation process, beginning with the publication on October 25, 2012, of CSA Consultation Paper 33-403 *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (**Consultation Paper 33-403**).

After publishing a status report[1] which indicated the key themes that emerged from the public comments on Consultation Paper 33-403, we followed up with Consultation Paper 33-404, published on April 28, 2016. Consultation Paper 33-404 set out our key concerns with respect to the client-registrant relationship and invited comment on a number of potential reforms to address those concerns. Consultation Paper 33-404 sought comment on proposed targeted reforms aimed at enhancing the obligations of registrants towards their clients, and a proposed overarching best

[1] CSA Staff Notice 33-316 – *Status Report on Consultation under CSA Consultation Paper 33-403*: *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, published December 17, 2013.

interest standard that would serve as the principle that would govern the interpretation of all other client-related obligations. Both consultation papers were followed by in-person consultations in a variety of forums, as well as the publication of research on conflicts of interest relating to registrants' compensation arrangements and incentive practices.[2]

We published a status report on our findings in CSA Staff Notice 33-319 *Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* (**Staff Notice 33-319**) on May 11, 2017, indicating that the CSA had identified certain reform areas that should be given higher priority. The Proposed Amendments were prioritized as they are fundamental to addressing the harms identified in Consultation Paper 33-404.

We intend to develop and propose for comment additional reforms relating to some of the proposals discussed in Consultation Paper 33-404. These are separate, longer-term projects, which will build on the comments we received on Consultation Paper 33-404. We are not seeking comment on these potential reforms at this time. They include:

- reviewing proficiency standards,
- reviewing titles and designations, including the use of "advisor" to describe individuals who are not registered in a category of adviser,
- imposing a statutory fiduciary duty when a client grants discretionary authority in those jurisdictions which don't currently have this provision, and
- clarifying the role of ultimate designated persons and chief compliance officers.

Response to Consultations

The extensive consultation process, including several outreach sessions, has allowed us to gather critical information on investor needs and registrant practices and concerns. We have carefully considered this information in developing the Proposed Amendments, and have reviewed and, in some cases, narrowed our earlier proposals.

A summary of the comments we received on Consultation Paper 33-404 and our responses to them are set out in Annex A. We thank all commenters for their helpful and detailed comments, and all participants in our outreach sessions and meetings.

Key Concerns

We have identified the following key investor protection concerns with respect to the client-registrant relationship, as discussed in more detail in Consultation Paper 33-404:

- **Clients are not getting the value or returns they could reasonably expect from investing**: in their suitability analysis, some registrants fail to consider all of the factors relevant to helping clients meet their investing goals.

[2] CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*, published in December 2016, provided the results of a survey conducted in 2014 to identify compensation arrangements and incentive practices that firms use to motivate their representatives' behavior that raise potential conflicts of interest. The SROs also published notices in December 2016 that raised similar concerns.

- **Expectations gap**: clients often have misplaced reliance on or trust in their registrants, which exacerbate the agency problem inherent in the client-registrant relationship and can result in sub-optimal investment decisions.

- **Conflicts of interest**: the application in practice of the current rules is, in many instances, less effective than intended in mitigating conflicts of interest.

- **Information asymmetry**: the current regulatory framework is, in many instances, less effective than intended in mitigating the consequences of the information and financial literacy asymmetry between clients and registrants.

- **Clients are not getting outcomes that the regulatory system is designed to give them**: this over-arching concern is to a large extent due to the combined effect of the concerns listed above.

Examples of the harms giving rise to these concerns include, among other things

- research that shows financial self-interest may inappropriately influence registrants' recommendations to clients,
- persistent findings in compliance reviews of inadequate KYC information collection, affecting registrants' capacity to make sound suitability determinations for clients, and
- the persistence of suitability as a leading source of client complaints.

Summary of Proposed Amendments

Introduction

As discussed above, the Proposed Amendments are client focused reforms that put the interest of the client before any other consideration relevant to the client registrant relationship. Throughout the Proposed Amendments, we also emphasize clarifying expectations for that relationship in order to address the expectations gap and information asymmetry concerns.

Some of the Proposed Amendments would impose new requirements, while others would codify best practices set out in existing CSA and SRO guidance. The combination of the codification of best practices and the introduction of new requirements will result in a new, higher standard of conduct for all registrants.

Unless otherwise noted, section references in the summary below are to provisions in the Regulation.

KYC – section 13.2 [Know your client]

The Proposed Amendments to the KYC requirements are our response to a primary area of concern in the industry and provide clarity on our expectations of what information a registrant must collect to 'know a client' and how frequently this information must be updated. These enhanced KYC requirements are intended to support the enhanced suitability determination requirement, which we propose to amend by requiring that registrants put the client's interest

first when determining suitability. This new requirement cannot be met without having complete and specific KYC information.

For example, we have noted that a proper assessment of a client's risk profile is often lacking, owing to insufficient KYC. This in turn leads to unsuitable investment recommendations, which form the primary basis for complaints to Ombudsman for Banking Services and Investments services (**OBSI**) for the past several years.

The Proposed Amendments would thus clarify the content and scope of the KYC process by requiring the registrant to gather specific information on the client, such as the client's personal circumstances, investment knowledge, risk profile and investment time horizon.

We propose to amend KYC requirements to require registrants to have a thorough understanding of their client, taking into consideration the nature of the specific client-registrant relationship. Registrants would be required to:

- gather sufficient information about the client to support an enhanced suitability determination obligation, and
- update KYC information at specified intervals

The Proposed Amendments would clarify the KYC requirements by means of the following changes:

- 13.2(2)(c) – explicitly sets out KYC information that must be collected by registrants in order for them to understand their clients well enough to meet their suitability determination obligations. The information required includes the client's
    - personal circumstances
    - financial circumstances
    - investment needs and objectives
    - investment knowledge
    - risk profile
    - investment time horizon

- 13.2(3.1) – new subsection requiring registrants to take reasonable steps to obtain clients' confirmation of the accuracy of their KYC information collected at account opening and when any significant change occurs

- 13.2(4.1) – new subsection specifying the circumstances when a client's KYC information must be reviewed and updated, including
    - when the registrant knows or reasonably ought to know of a significant change in a client's KYC information, and
    - in any event, at minimum intervals of
        - 12 months for managed accounts
        - 12 months prior to making a trade or recommendation for exempt market dealers
        - 36 months for other accounts

We propose significantly expanded guidance in the Policy Statement with respect to our expectations for these requirements. This includes, among other things, discussions of

- our expectations with respect to the establishment of a client's investment needs and objectives, taking into account the client's financial goals, as well as the development of the client's risk profile,
- the ways a registrant may tailor its KYC process to reflect its business model and the nature of its relationships with clients, and
- the collection of KYC information using technology.

KYP – new section 13.2.1 [Know your product]

There is currently no explicit Regulation 31-103 requirement concerning KYP, while the Policy Statement provides only limited principles-based guidance on our KYP expectations in the context of the proficiency and suitability requirements. We have determined that there should be an express KYP requirement in Regulation 31-103, as well as more detailed guidance in the Policy Statement, in order to codify our KYP expectations of firms and registrants as set out in previous CSA and SRO guidance. We have also determined that there should be greater detail in the Policy Statement to provide clarity on those expectations.

The Proposed Amendments to KYP are also intended to support an enhanced suitability determination requirement, as well as increase rigour and transparency around the securities and services that registrants make available to their clients.

Although we have not moved forward with certain of the KYP proposals from Consultation Paper 33-404, several new elements have been added to registrants' KYP obligations in the Proposed Amendments, such as a requirement that firms understand how securities that they make available to clients compare to similar securities available in the market and a requirement that firms maintain an offering of securities and services that is consistent with how they hold themselves out and market their services.

The Proposed Amendments would add a new section 13.2.1 [*Know your product*] to Regulation 31-103 to impose explicit KYP requirements at both the registered firm and registered individual levels, including:

- 13.2.1(1) – obligations of a registered firm to
    - take reasonable steps to understand the essential elements of the securities it makes available to clients, including how they compare with similar securities available in the market
    - approve the securities it will make available
    - monitor and reassess its approved securities

- 13.2.1(2) – principles-based requirement that a registered firm must maintain an offering of securities and services that is consistent with how it holds itself out

- 13.2.1(3) – obligations of registered individuals to take reasonable steps to
    - understand at a general level, the securities that are available for them to purchase, sell or recommend through their firm, and how those securities compare

    - thoroughly understand each specific security they purchase, sell or recommend to a client, including the impact of all of the costs associated with acquiring and holding the security

- 13.2.1(4) – registered individuals must only purchase or recommend securities approved by their firm

- 13.2.1(5) – registered firms must ensure that their registered individuals have the necessary information about each approved security

- 13.2.1(6),(7) – tailored requirements and exemptions relating to certain client directed trades and transfers, portfolio manager directed trades, and securities offered through order-execution-only services

We propose guidance in the Policy Statement with respect to our expectations as to how registrants may meet their KYP obligations. The guidance is detailed and pays particular attention to setting out our views concerning the process of approving a security, product costs, compensation structures and the use of proprietary products, and the importance of taking related conflicts of interest into account.

Suitability – section 13.3 [Suitability determination]

The changes we propose to make to the suitability obligation are extensive, and are responsive to concerns about the current suitability process. As stated above, unsuitable recommendations generate the majority of complaints to OBSI, indicating an imbalance in the client-registrant relationship. We have chosen a regulatory approach which favours the client's interest above other considerations, while at the same time providing registrants with more specific requirements to enable them to make appropriate suitability determinations.

We propose enhanced suitability obligations that would introduce a new core requirement that registrants must put their clients' interests first when making a suitability determination. Enhanced suitability obligations would also include:

- explicitly requiring registrants to consider certain factors, including costs and their impact, in making suitability determinations,
- moving away from trade-based suitability to an overall portfolio-level suitability analysis, and
- prescribing triggering events that will require a registrant to reassess suitability.

The Proposed Amendments would make the following changes to section 13.3 [*Suitability determination*]:

- 13.3(1) – current suitability requirement replaced with new subsection providing that before a registrant acts by opening an account for a client, purchasing, selling, depositing, exchanging or transferring securities for a client's account, taking any other investment action for a client or making a recommendation or decision to take any such action, the registrant must determine, on a reasonable basis, that the action

- is suitable for the client, based on certain factors, including
    - KYC information
    - the registrant's understanding of the security
    - the features and associated costs of the account type
    - the impact on the account
    - portfolio-level concentration and liquidity
    - the analysis of the actual and potential impact of costs
    - available alternatives at the firm
    - any other relevant factor under the circumstances
- puts the client's interest first

- 13.3(2) – new subsection prescribing trigger events that will require registrants to review a client's account and the securities in the account in accordance with subsection 13.3(1) and take appropriate action, promptly after these events occur
    - a new registered individual is designated as responsible for the client's account
    - a change in a security in the account
    - a change in the client's KYC information
    - the registrant undertakes a required review or update of the client's KYC information
    - the registrant becomes aware that a security in the client's account or the account does not meet the criteria under subsection 13.3(1)

- 13.3(2.1) – new subsection replacing current provision for client-directed trades

We propose guidance in the Policy Statement with respect to our expectations as to how registrants may meet their enhanced suitability obligations. We clarify that, in order to ensure that the suitability obligation has been met, our review will be undertaken on the basis of what a reasonable registrant would have done under the same circumstances.

Conflicts of interest – Part 13: Division 2 [Conflicts of interest]

Conflicts of interest have been identified as a key concern in the client-registrant relationship. We have adopted a best interest standard in the Proposed Amendments relating to conflicts of interest because that standard:

- reflects our expectation of how conflicts must be addressed,
- has been given clear meaning in relation to conflicts of interest, which will assist in effective compliance with our expectations, and
- will help address the expectations gap between clients and registrants as described in Consultation Paper 33-404.

We have also determined that current conflicts of interest requirements require further reforms

- specifying that all conflicts of interest must be addressed, not only those that are material,
- expressly applying conflicts of interest obligations to registered individuals, as well as their sponsoring firms,
- adding guidance relating to particular conflicts of interest, such as conflicts arising from sales and incentive practices and compensation arrangements, including the acceptance of

compensation from third parties (such as embedded commissions) and the use of proprietary products,
- restricting certain referral arrangements, and
- expanding recordkeeping in Part 11, particularly as it concerns sales practices, compensation arrangements and other incentive practices.

The conflicts of interest requirements are fundamental registrant conduct obligations that protect investors. The Proposed Amendments to the conflicts of interest requirements will raise the bar for registrant conduct. The Proposed Amendments would require all existing and reasonably foreseeable conflicts, not just material conflicts, to be addressed in the best interest of the client.

In order for a registered firm to properly address conflicts in the best interest of their clients, a firm must accurately identify all conflicts in a timely way. We expect that these Proposed Amendments will improve the timeliness of conflict reporting by registered individuals to their sponsoring firms and will help registered firms ensure that all existing and reasonably foreseeable conflicts are addressed in the best interest of the client, in a timely manner. With respect to conflicts that are not material, registered firms can satisfy the conflicts of interest rule by addressing those non-material conflicts in a manner that is proportionate to the limited risk that such conflicts may pose to affected clients. The Proposed Amendments to the Policy Statement contain additional guidance on how we expect registrants to address non-material conflicts.

The Proposed Amendments would make the following changes to Division 2 [*Conflicts of interest*] of Part 13:

- 13.4 [*A registered firm's responsibility to identify conflicts of interest*] and 13.4.1 [*A registered individual's responsibility to identify conflicts of interest*] – new and revised sections
    - expanding the obligation to take reasonable steps to identify *all* conflicts of interest (including those that are reasonably foreseeable) beyond those that are material
    - specifying that the obligation applies to both registered firms and registered individuals
    - requiring registered individuals to promptly report conflicts of interest they identify to their sponsoring firms

- 13.4.2 [*A registered firm's responsibility to address conflicts of interest*] – new section requiring registered firms to address all conflicts of interest between the firm (including each individual acting on its behalf), and the firm's client, in the best interest of the client. If a conflict is not, or cannot, be addressed in the best interest of the client, then the registered firm must avoid that conflict

- 13.4.3 [*A registered individual's responsibility to address conflicts of interest*] – new section imposing on registered individuals the same obligations as set out in section 13.4.2, and also providing that they must not proceed with any activity related to an

identified conflict of interest unless that conflict has been addressed in the best interest of the client and they have received the consent of their sponsoring firm

- 13.4.4 [*Conflicts of interest that must be avoided*] – new section setting out certain conflicts that must be avoided (subject to appropriate exceptions), including those involving
    - borrowing money from a client
    - lending money to a client
    - having control over the financial affairs of a client

- 13.4.5 [*Conflicts disclosure*] – new section extending disclosure requirements to all identified conflicts of interest that a reasonable client would want to know about and specifying
    - that disclosure must now include, in addition to the nature and extent of the conflict of interest
        - the potential impact and risk that it may have on the client, and
        - how it has been, or will be, addressed
    - that disclosure must be prominent, specific and written in plain language
    - the times when disclosure must be made
    - that disclosure is not in itself sufficient to satisfy the obligation to address conflicts of interest in the best interest of the client

Division 3 [*Referral arrangements*]

- 13.7 [*Definitions – referral arrangements*] and 13.8 [*Permitted referral arrangements*] – expanded to
    - prohibit payment of a referral fee by a registrant unless
        - the party receiving the fee is also a registrant
        - the referral fee is compliant with new section 13.8.1
        - the terms of the referral arrangement are set out in a written agreement between the firm, and the other party to the referral
        - the registered firm records all referral fees
        - the registered firm ensures that the information prescribed by subsection 13.10(1) [*disclosing referral arrangements to clients*] has been provided to the client in writing

- 13.8.1 [*Limitation on referral fees*] – new section providing that a referral fee must not
    - continue for longer than 36 months
    - constitute a series of payments that together exceed 25 percent of the fees or commissions collected from the client by the party who received the referral
    - increase the amount of fees or commissions that would otherwise be paid by a client to that registrant for the same product or service

Division 7 [*Misleading communications*]

- 13.18 [*Misleading Communications*] – new section providing that

- registrants must not hold their services out in any manner that could reasonably be expected to deceive or mislead any person as to:
    - their proficiency, experience, or qualifications
    - the nature of the person's relationship, or potential relationship, with the registrant
    - the products or services provided, or that may be provided
- registered individuals must not use a title, designation, award, or recognition that is based partly or entirely on that registrant's sales activity or revenue generation
- registered individuals must not use a corporate officer title unless their sponsoring firm has appointed that registrant to that corporate office pursuant to applicable corporate law
- registered individuals may only use a title or designation with the approval of their sponsoring firm

We also propose extensive new guidance in the Policy Statement with respect to our expectations as to how registrants could meet enhanced conflicts of interest obligations. The guidance addresses, in view of the proposed elimination of the materiality threshold in section 13.4, the spectrum of materiality of conflicts of interest and our expectations concerning immaterial conflicts.

The guidance also identifies and directly addresses some conflicts of interest that give rise to key concerns and provides examples of controls that registered firms can consider putting in place when trying to address such conflicts in the best interest of their clients. These conflicts include:

- using proprietary products, including where firms make available both proprietary and non-proprietary products,
- receiving third party compensation,
- entering into referral arrangements, and
- internal compensation arrangements and incentive practices.

RDI – Part 14 [Handling client accounts – firms], Division 2 [Disclosure to clients]

We have identified shortcomings in the relationship disclosure information that some clients receive from their registrants, despite the fact section 14.2 provides that: "A registrant must deliver to a client all information that a reasonable investor would consider important about the client's relationship with the registrant" and sets out a list of mandated disclosures.

We are particularly concerned that registrants do not always provide adequate disclosure about

- their use of proprietary products,
- limitations on the products and services that they will make available to a client, (including restrictions based on the firm's registration category or terms and conditions on its registration, as well as business decisions to limit what the firm offers to clients based on their account type or the amount of money they invest), and
- the impact each of these things can have on investment returns.

We believe clear disclosure of this information is important to ensure that clients have an adequate understanding of the relationship with their registrant. We therefore propose to add this information to the mandated disclosures in subsection 14.2(2).

Our research and consultations have also led us to conclude that we should expand disclosure requirements to recognize that expectations begin to be shaped before someone becomes a client of a registered firm. If investors have ready access to basic information about competing firms' products and services including the costs associated with those products and services, they will find it easier to choose a firm that is likely to meet their expectations.

We are therefore proposing a new provision that would require registered firms to make publicly available the information that potential clients would consider important in deciding whether to become a client. This is stated as a principle and a list of key things that must be covered. Firms are not required to try to anticipate *all* information that any investor *might* wish to consider, and there is no prescribed form or requirement to include an exhaustive product list. We anticipate that firms will post the information on their websites, or reply to requests by email or by giving out short print-on-demand documents.

To implement these requirements, the Proposed Amendments would make the following changes:

1.1 [*Definitions*] – new defined term "third-party compensation" added to simplify drafting and ensure clarity of regulatory purpose

Part 14 [*Handling client accounts – firms*],

New Division 1.1 [*Publicly available information*]

- 14.1.2 [*Duty to provide information*] – new requirement that a registered firm must make publicly available information that a reasonable investor would consider important in deciding whether to become a client of the firm, including general descriptions of:
    - the products, services and account types that it offers
    - any material limitations or restrictions on what is made available (e.g., minimum investments, qualified purchaser etc.)
    - charges and other costs to clients
    - any minimum account sizes or minimum charges
    - any third-party compensation associated with the firm's products, services and accounts

Division 2 [*Disclosure to clients*]

- 14.2(0.1) – new defined term "proprietary product" added to simplify drafting and ensure clarity of regulatory purpose

- 14.2(2)(b) – current requirement for a general description of the products and services the registered firm offers to the client expanded to include express requirement to disclose whether
    - the firm will primarily or exclusively use proprietary products in the client's account
    - there are any restrictions on the products or services the registrant will provide to the client

- 14.2(2)(k) – current requirement for disclosure of the obligation to make suitability determinations is conformed with the suitability amendments in section 13.3

- 14.2(2)(l) – revises the current requirement to provide a client with the KYC information that the firm has collected from them, in order to remove ambiguity and clarify the regulatory intent consistent with the existing guidance in the Policy Statement

- 14.2(2)(o) – new requirement to explain the potential impact of each of the following on a client's investment returns
    - operating and transaction charges
    - embedded fees
    - having access to only a limited range of products or services

We also propose additional guidance in the Policy Statement, setting out our expectations as to how registrants can satisfy the new obligations in the Proposed Amendments. In doing so, we build on existing guidance about our expectations that registrants will present disclosure information to clients in a clear and meaningful way in order to ensure they understand the information presented, which is consistent with registrants' obligation to deal with clients fairly, honestly and in good faith.

Part 3 [Registration requirements – individuals], Division 2 [Education and experience requirements]

In view of the proposals for strengthened requirements regarding conduct toward clients and KYP, we believe it is necessary to mandate registered firms to establish training programs for their registered representatives.

The Proposed Amendments would add:

- 3.4.1 [*Firm's obligation to provide training*] – new section requiring registered firms, other than investment fund managers, to provide training to their registered individuals on:
    - compliance with securities legislation, including
        - conflicts of interest requirements,
        - the KYC and KYP obligations, and
        - the obligation to make a suitability determination, and
    - prescribed elements of the securities available through the firm

We also propose new guidance in the Policy Statement setting out our expectation that registered firms will develop, implement and maintain training programs that include examples of how to identify conflicts of interest and how to address them in the best interests of their clients.

Part 11 [Internal controls and systems], Division 2 [Books and records]
Maintaining an effective compliance system is a cornerstone obligation of registered firms. The elements of an effective compliance system are detailed in Part 11 of Regulation 31-103 and the Policy Statement. We expect all registrants to review and amend their compliance systems to reflect the new requirements, which should be tailored to their size and scope of operations, including products, types of clients, risk and compensating controls and any other relevant factors.

In particular, we expect all registrants to implement changes to their policies, procedures and controls to address conflicts of interest in the best interest of their clients and to establish a framework where the registrant puts the client's interest first when making suitability determinations.

The Proposed Amendments include:

- 11.5 [*General requirements for records*] – recordkeeping requirements expanded to include
    - demonstrating compliance with KYP requirements
    - demonstrating how the firm has addressed, or plans to address, conflicts of interest identified under subsections 13.4 and 13.4.1 in the best interest of its clients
    - documenting the firm's
        - sales practices
        - compensation arrangements
        - incentive practices
    - demonstrating compliance with requirements about documenting the use of titles and designations by the firm's registered individuals
    - demonstrating compliance with the enhanced disclosure requirements discussed above

We also propose new guidance in the Policy Statement setting out our expectations as to how registrants may accommodate the Proposed Amendments in their compliance systems.

Exemptions

The Proposed Amendments do not apply in the following situations:

- for registrants dealing with certain permitted clients, the Proposed Amendments relating to suitability and KYC requirements do not apply;
- for registrants dealing with clients in the context of order-execution-only ("discount brokerage services"), and portfolio manager directed trades, suitability and related KYP requirements do not apply;

- for registered investment fund managers, conflicts of interest obligations set out in sections 13.4 to 13.4.5 do not apply in respect of investment funds that are subject to *Regulation 81-107 respecting Independent Review Committee for Investment Funds.*

Part 9 [Membership in an SRO], Custody obligations for mutual fund dealers registered in Québec that are MFDA members

For clarity, we are also proposing an amendment to section 9.4 [*Exemptions from certain requirements for MFDA members*] by adding in subsection 9.4(3) that mutual fund dealers registered in Québec that are MFDA members may rely on certain of the exemptions in subsections 9.4(1) and (2) relating to custody of assets, provided the conditions of the exemption are met.

Transition

We are considering a phased implementation schedule for the final amendments:

- Referrals – immediately upon coming into force, except 3 years to bring pre-existing arrangements into conformity;
- RDI – 1 year to provide publicly available information under new requirement; 2 years for the other new requirements;
- KYC, KYP, suitability and conflicts of interest – 2 years.

We invite your comments on this schedule.

Questions

We invite views on the questions below. Please provide a specific response.

Transactional relationships

Exempt market dealers often have transactional or "episodic" relationships with their clients, in contrast to the ongoing character of client relationships in other categories. Would the Proposed Amendments pose implementation challenges unique to transactional relationships, or would they have other unintended consequences related to them?

Conflicts that must be avoided

Are there other specific conflicts of interest that cannot be addressed in the client's best interest and must be avoided?

Referral fees

Does prohibiting a registrant from paying a referral fee to a non-registrant limit investors' access to securities related services? Would narrowing section 13.8.1 *[Limitation on referral fees]* to permit only the payment of a nominal one-time referral fee enhance investor protection?

Request for comments

We welcome your comments on the Proposed Amendments.

Please submit your comments in writing on or before October 19, 2018. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Address your submission to all of the CSA as follows:

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

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA members.

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax : 514 864-6381
consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416 593-2318
comments@osc.gov.on.ca

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of the written comments received during the comment period. All comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the Autorité des marchés financiers at www.lautorite.qc.ca, and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include

personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Questions

Please refer your questions to any of the following:

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ANNEX A

SUMMARY OF COMMENTS ON CONSULTATION PAPER 33-404 AND RESPONSES

This annex summarizes, at a high level, the written public comments we received on Consultation Paper 33-404 and our responses to those comments. Approximately 85% of the comment letters we received were from industry stakeholders (including registrants, industry associations and law firms), and approximately 15% of the comment letters were from non-industry stakeholders (including investors, investor advocates, academics and others).

For clarity, the comments and responses are organized as follows:

1. Comments and responses on the conflicts of interest proposals
2. Comments and responses on the KYC proposals
3. Comments and responses on the KYP proposals
4. Comments and responses on the suitability proposals
5. Comments and responses on the RDI proposals

1. Comments and responses on the conflicts of interest proposals

General

We received mixed comments on the proposal with respect to conflicts of interest, although most commenters agreed that conflicts are an important area for the CSA to focus its efforts. There was disagreement about whether disclosure alone should be sufficient to address conflicts. Some commenters maintain that disclosure is an effective means of addressing conflicts and question the CSA research described in Consultation Paper 33-404 on the limitations of disclosure.

A few commenters mentioned that requiring more disclosure could have a significant and disproportionate adverse effect on integrated firms and on capital raising. Others believe that the CSA will not be able to effectively address conflicts unless compensation and incentives issues are dealt with, and which disclosure alone will not address.

In addition, there was support for updating, expanding and enforcing *Regulation 81-105 respecting Mutual Fund Sales Practices* and related Companion Policy and for considering more generally monetary and non-monetary incentives internal to a dealer firm that favour the distribution of certain products over others, including proprietary products.

Effectiveness of the current rules governing conflicts of interest
Several commenters assert that existing rules are sufficient to regulate how registrants should respond to conflicts, whether in Regulation 31-103, SRO rules or professional codes of conduct, to address our concerns. It has been suggested that we should focus on enforcing these existing requirements and provide guidance to uphold the rule. In addition, several commenters suggested we align our proposals with SRO rules or clarify how our proposals differ from those requirements. If there is a gap for registrants that are not overseen by SROs, the commenters indicate that we should address it in order to ensure clients receive similar treatment regardless of the type of registrant or business model a registrant operates.

While some commenters think disclosure is an effective means of addressing conflicts, a few commenters believe that disclosure alone is not a sufficient remedy for dealing with conflicts, as it tends to reinforce trust in registrants.

Almost all commenters have expressed the view that the requirement that registrants have a "reasonable basis" for concluding that a client "fully understands" the implications and consequences of a conflict is problematic. They believe it would be difficult for a registrant to evidence this and satisfy regulators that such requirement has been met.

Prioritizing the client's interest
Commenters were fairly equally divided about whether the requirement to prioritize the interests of a client ahead of the firm in resolving conflicts is appropriate. Many are in favor of prioritizing the client's interest but are concerned about the practical implications of operationalizing such a standard. Others expressed the view that where multiple courses of action could be taken, the one that maximizes the interest of the client should be selected.

It has been suggested that we should provide specific guidance on the types of conflicts that are so significant they must be avoided and cannot be addressed through disclosure. In addition, the CSA should give examples of measures that may be taken to control conflicts in a manner that prioritizes the interest of the client. Finally, some commenters suggested that conflicts should be resolved in a manner that is "consistent with" the interests of the client, or "not detrimental to" the interests of the client.

Specific registration categories or business models
Several commenters raised concerns with the "one-size-fits-all" approach, namely applying the same standard to all registration categories and business models. Commenters expressed the view that this approach may present challenges for some firms, and have requested guidance to clarify our expectations for different registration categories and business models, such as firms that offer proprietary products.

CSA Response
Existing rules are not sufficient to achieve the outcome we are seeking of creating an obligation to respond to the conflict once identified and to prioritize the interest of clients ahead of the registrant.

Disclosure alone is not sufficient to address a conflict of interest in the best interest of clients. In other words, disclosure in conjunction with other controls must be used to address a conflict of interest in the best interest of clients. We also propose guidance on what would be appropriate controls to address different types of conflicts, and what conflicts are so significant that they must be avoided.

With respect to the "one-size-fits-all" approach under this new requirement, as introduced in Consultation Paper 33-404, we do not propose scalability measures for the conflicts requirements. The conflict of interest standard is a fundamental registrant-conduct standard, similar to the fair dealing rule, which should not vary based on the registrant's business model, registration category, or the type of client.

We propose an obligation to identify and respond to conflicts by both the representative and the firm and we use the same standard for both, and provide guidance on procedures and controls that firms could implement to address the conflicts.

Moreover, we considered carefully the concerns previously raised on conflicts that arise from compensation arrangements and incentive practices as prescribed in Regulation 81-105. The Proposed Amendments related to the conflicts of interest will provide guidance to registrants on how to address various types of conflicts arising from compensation arrangements and incentive practices.

Finally, with respect to proprietary products, we propose more guidance in Policy Statement 31-103 generally on how firms can manage conflicts raised by the sale of proprietary products, and how firms with different business models (e.g. integrated mutual fund dealers, exempt market dealers, firms that offer proprietary products in addition to non-proprietary products, firms that only offer proprietary products) could comply with the requirement under the proposed Regulation 31-103.

2. Comments and responses on the KYC proposals

General

In general, the commenters who provided comments on KYC proposals were critical of the proposed reforms to section 13.2 of Regulation 31-103. Several commenters believe that regulators are aiming for a one-size-fits-all approach to the collection of KYC information. They expressed the need for KYC obligations to be scalable in accordance with the level of service desired by clients.

Level of proficiency on tax related matters

Several commenters believe that collecting tax information when the representatives do not have any tax expertise does not serve the interest of investors, creating risks of reliance and a potential for errors which could harm clients. Because the required industry courses only provide a basic outline, registrants should not be encouraged through regulation to give advice on tax strategies. This could result in investors not seeking independent tax advice and could cause investors to believe that they are receiving tax or financial planning advice when this is not the scope of the agreed upon professional relationship.

Furthermore, many commenters believe that clients may perceive requests for this information as an intrusion in their affairs, and not all clients may be willing to provide this information. Finally, requiring the collection of tax information may increase significantly the costs of professional liability insurance and consequently, the service fees paid by clients.

However, certain commenters outlined that registrants should have a better understanding of clients' tax position and thus, receive more training in tax matters.

Codification of the new account form or the specific form used to collect the prescribed KYC content

The large majority of commenters disagree with codifying the specific form of the document, or a new account application form to collect the prescribed KYC information. The majority of commenters are of the opinion that the proposal to have a specific KYC form, as a distinct document from the other documents in the account opening package, would have the effect of inundating the client with paper work. Different practices are noted, for example some IIROC dealers do not provide for a specific KYC form.

In addition, some commenters believe that the CSA should delegate this direction to the SROs, as they are in a better position to monitor this activity and provide further guidance as needed. It has been suggested that the CSA should adopt a principles-based approach to the form of this document or set out specific guidance regarding minimum KYC criteria to be adopted by firms as part of their KYC protocols.

While several commenters expressed concerns about mandating a specific form of document, one commenter encouraged the CSA to work with scholarship plan dealers to establish uniform and consistent KYC information.

With respect to the form of the risk profiles, commenters are mostly negative on the risk profile proposal, with its requirement to carry out a "thorough exploration of the relevant subjective and objective factors". They view this requirement as not being within regulator expertise, and unresponsive to the variety of current business models.

Signature of the KYC form

Several commenters expressed an objection to this proposal, mainly for technological reasons as not all dealers have a paper-based KYC collection and approval process. One commenter has suggested that the word "signed" should have a definition consistent with current technology and would allow, for example, an on-line review and approval rather than requiring a signature on a physical piece of paper.

Additionally, one commenter has suggested that the CSA should provide guidance indicating sufficient flexibility to accommodate clients' preference for digital communications and to allow digital client acknowledgments and confirmations, for example by reply e-mail, in lieu of physical signatures. Another commenter outlined that registrants are already subject to extensive supervision by the dealer to ensure compliance with SRO rules. The majority of commenters believe that supervisory signatures would consume management time, and would not add meaningfully to investor protection.

With respect to the proposed requirement to update KYC information every 12 months, several commenters believe it would significantly detract from registrants' primary responsibility of advising their clients and managing their accounts. This is considered by the commenters as being costly and cumbersome. To mitigate this, and related consequences, it has been suggested to the CSA to preserve flexibility for registrants in refreshing KYC information. The commenters believe this should continue to be tailored for different advisory models. For example, the exempt market dealer model, with its challenges on the issue of whether or not there is a continuing client-registrant relationship, may be problematic in this respect.

Commenters also indicated that clients sometimes refuse to provide the requested information, while others choose not disclose it without the registrant's knowledge.

CSA Response

In the KYC Proposed Amendments, we propose a more principles-based approach for KYC reforms, removing some of the more prescriptive elements proposed in Consultation Paper 33-404, and keeping the requirements scalable across different types of client relationships and the level of service desired. In addition, the existing SRO rules have been taken into account.

As suggested by several commenters, we do not require the collection of tax information, but may in future focus on increasing the proficiency of representatives on basic tax issues. Moreover, we have not mandated a specific KYC form. However, we identify certain essential elements of KYC that should be mandated and required for all types of business models and client relationships.

We have also reexamined parts of the guidance on KYC in Policy Statement 31-103, which outlines our expectation on the due diligence process that firms should put in place regarding the KYC process, ensuring that the process is flexible enough to take into account various business models and the spectrum of client relationships and needs. In addition, Policy Statement 31-103 contains guidance on other matters, including:

- key elements to be considered by the registrant with respect to the collection of KYC information,
- client's authorization for the KYC information collected both at initial account opening and upon material changes, and
- frequency with which the KYC information should be updated.

3. Comments and responses on the KYP proposals

General

Commenters were generally very critical of the KYP proposals for both registered firms and representatives. Commenters generally agreed that the proposed reforms would be unworkable, be costly, advantage proprietary firms and cause serious unintended consequences.

The CSA considered the comments received on the KYP proposals for both registered firms and representatives and, in particular, considered the likelihood of the unintended consequences of

the KYP proposals raised by commenters if the reforms were to be implemented as proposed in Consultation Paper 33-404. The CSA have significantly redesigned the proposals.

KYP proposals for representatives

Commenters generally agreed that the proposals that representatives have a thorough understanding of all securities on their firm's product list and how those securities compare to one another are not workable. They assert that it is not possible for a representative to have such an in-depth knowledge of every security on the firm's product list, unless the product list itself is limited, and not every representative has the expertise to sell all securities available at a registered firm. In addition, they assert that this requirement may pose challenges for certain types of registrants, including advising representatives of portfolio management firms (where the universe of securities may be available to those representatives) as well as firms with multiple divisions, where all securities offered by the firms may not be able to be sold by all representatives. Commenters expressed concern that such a requirement would cause the narrowing of product lists and reduced investor choice.

An alternative approach recommended was that representatives should know and understand the products they recommend in light of the needs of their clients, and that the CSA should focus instead on the process for product due diligence. Some commenters expressed support for a requirement that representatives know general categories of securities or asset classes, and the general range of products available to clients at the firm.

KYP proposals for firms

In Consultation Paper 33-404, we asked commenters to respond to various questions relating to the differentiation of firms by product list (e.g., proprietary and mixed / non-proprietary) and proposed KYP requirements for certain firms to undertake a market investigation, product comparison, and a product list optimization process. As we are not proceeding with these reforms as proposed, we have outlined and responded in a general way to the concerns raised by commenters.

The vast majority of commenters were very critical of the KYP proposals for registered firms. Some commenters felt that the distinction between proprietary and mixed/non-proprietary firms would not be clear or meaningful, and some commenters felt that the definition of what is "proprietary" would need careful consideration even if the distinction had value. In any event, a major concern of commenters related to the fact that the KYP requirements differed between these two types of firm and that the requirements applying to mixed/non-proprietary firms were onerous. Commenters generally agreed that the proposed requirements for mixed/non-proprietary firms to undertake a market investigation, product comparison, and a product list optimization process would be costly, would advantage proprietary firms, and would cause serious unintended consequences, such as:

- firms will narrow their product lists;
- firms may move to a proprietary model;
- reduced choice for investors;
- small firms would exit the industry / there would be industry consolidation;
- there would be an adverse impact on independent product manufacturers.

CSA Response
We have considered the comments received and have redesigned the KYP proposals for representatives. The KYP Proposed Amendments include:

- a more practical and workable requirement that registered individuals generally understand the securities available for them to trade in or recommend to clients, and generally understand how those securities compare to one another; and
- a requirement that registered individuals thoroughly understand securities they trade in or recommend to clients.

We have maintained the emphasis from Consultation Paper 33-404 on a representative understanding all costs associated with a security being recommended and the impact of those costs.

We have also considered the comments received on the KYP proposals for firms and recognize the concern of commenters that there may be serious unintended consequences if they were to be implemented as proposed in Consultation Paper 33-404. We have therefore significantly redesigned the proposals, and have not carried forward the market investigation, product comparison and product list optimization requirements for firms, nor have we imposed requirements that are differentiated between proprietary and mixed/non-proprietary firms.

We have instead proposed reforms that are designed to increase rigour and transparency around the securities and services that registrants make available to their clients. These reforms are intended to work together with reforms to conflicts of interest and RDI, and support enhanced suitability determination requirements. In addition, we have proposed a principles-based requirement that a firm must ensure that the securities and services it offers are consistent with how it holds itself out to clients.

4. Comments and responses on the suitability proposals

General
The comments received on the suitability proposed reforms were significant, extensive in most instances and occasionally divided, such as on the issues of what makes an investment "most likely" to achieve a client's needs and objectives, and what it means to accept an instruction to "hold" an investment. A remark that was recurrent in many comments on the suitability proposed reforms was related to how the proposals would be assessed and reviewed by in-house compliance staff and be enforced by regulators.

In addition, commenters believe that the requirement to perform a suitability analysis at least once every 12 months raises challenges for most registrant categories or business models. It has been suggested that this may be overly cumbersome, inefficient and costly or simply unnecessary for clients with modest balances and where no changes have occurred in client circumstances during the year.

Finally, many commenters do not believe it is necessary for a significant market event to trigger a new and full suitability analysis in all instances where the client is exposed as it may not lead

to a different outcome. According to several commenters, it is unlikely that a market event, even if significant, will have changed the nature of the risk profile of a particular security or the client's portfolio. Likewise, the commenters observed that a material change in the risk profile of a single issuer should not, in a portfolio that is suitable, be cause for an immediate suitability analysis in all instances.

Financial strategies as part of the suitability determination process

As per the proposal to consider other basic financial strategies in determining suitability, the majority of comments received noted that this approach assumes that all clients want or need a) a full financial plan, or b) to have their entire investment strategy and the composition of their portfolio (re)assessed, regardless of the clients' expectations or the registrant's business model. Most believe this requirement may result in registrants providing advice in areas where they do not have the required expertise.

Potential challenges of the implementation of the requirement to ensure that a purchase, sale, hold or exchange of a product is the "most likely" to achieve the client's investment needs and objectives

With respect to the requirement to ensure that a purchase, sale, hold or exchange of a product is the "most likely" to achieve the client's investment needs and objectives, most commenters are of the opinion that this standard would be highly susceptible to after-the-fact second-guessing, which would expose firms to unnecessary compliance costs and potential legal and regulatory risks.

Some commenters believe that this requirement could establish unrealistic client expectations of guaranteed outcomes and needs to be clarified. Others suggested replacing the phrase "most likely" by something that acknowledges the decision was made in the context of subjective factors that were present at the time, such as "likely in the context in which the decision was made."

Other formulations such as "reasonably likely to achieve" and "reasonable under the circumstances" were suggested by commenters. Finally, several commenters believe that this requirement would result in fewer product choices for investors as firms look to reduce their product shelves to be able to comply with the requirement. They are of the view that this could also result in a reduction of qualified, experienced registrants available to service a wide range of investors.

Key elements determining the suitability of an investment

Commenters outlined that by increasingly clarifying the scope of the rule with respect to these requirements, the CSA run the risk of standardizing practices, with implications for loss of competitiveness and operating costs, as well as the need to multiply the exceptions to be managed. These commenters recommend a more principle-based approach rather than a detailed, prescriptive approach.

CSA Response

We agree with comments that the use of the phrase "most likely" and referring to "client's investment objectives" could establish unrealistic client expectations of guaranteed outcomes.

Instead, the CSA propose that there must be "a reasonable basis" to conclude that an investment action taken by a registrant satisfies prescribed criteria for a suitability determination. That determination would not only require that an investment action taken by a registrant be suitable based on prescribed factors, but also that it puts the client's interest first.

We propose further guidance in Policy Statement 31-103 and various examples which illustrate how we expect the firm to implement this requirement.

Additionally, we propose a requirement that suitability be assessed on a portfolio basis, rather than trade-by-trade only and specify circumstances when suitability should be reassessed.

5. Comments and responses on the RDI proposals

General

The comments received on the RDI proposals were generally supportive of the principles of transparency, meaningful disclosure and clarity as they relate to the client-registrant relationship. However, there were warnings against adding to the amount of RDI that registrants are already required to deliver. It was suggested that many clients do not read the existing disclosures because they find them to be too long. There were also several commenters who said that it would be better to wait and see the effects of implementing the Client Relationship Model Phase 2 and mutual funds Point of Sale requirements before making further enhancements to client disclosure requirements.

There was support for additional guidance on RDI, but no consensus. Some commenters felt it would be unnecessary. Some suggested principles-based guidance would be better than a prescriptive approach to enable flexibility among business models. One argued for mandated RDI forms, taking the view that guidance alone would be ineffective. There were several strong objections to the proposition in the proposed general disclosure guidance that registrants should have a "reasonable basis for concluding that a client fully understands the implications and consequences for the client of the content being disclosed" from commenters who felt it would be very difficult to operationalize.

Registration in a restricted category

Several commenters were supportive of the proposal that firms registered in a restricted category would be required to include that information in their RDI. They agreed that this information would enable investors to make more informed decisions, and thought the proposal would be workable. Several others objected because they felt that "restricted" would be perceived as having negative connotations and an implication that some types of firms are better than others.

Commenters also objected to the proposed requirement for restricted firms to inform clients that a full range of securities would not be considered in their suitability analyses. They questioned the practical benefits of having such a requirement, and raised the potential for the unintended consequence that investors might assume that suitable products offered by a restricted registrant are insufficient for their needs. It was suggested that the proposed disclosure for restricted category firms assumes, wrongly, that all investors have a realistic option of becoming a client of

a full service firm. Some investor advocates argued that disclosure would be inadequate, based on the limitations of what investors understand about their investment options.

Use of proprietary products

Many commenters supported disclosure concerning the use of "proprietary products", at least in principle. However, there were concerns about client confusion about the meaning of the phrase, particularly when extended to the concept of a firm with a "mixed /non-proprietary" product shelf. Commenters expressed concerns that the potential for unintended consequences outweighs the potential benefits of such disclosure. Common objections relating to the challenge of making the information meaningful to clients included:

- some firms that would be categorized as mixed/non-proprietary may offer a much broader range of products than others,
- what a given firm offers some types of client may differ from what it offers others,
- proportions of proprietary and non-proprietary products may change frequently, and
- there may be a perceived implication that one type of product is inherently better.

CSA Response

We acknowledge the concern that to be genuinely useful, client communications, including RDI, must not be allowed to become overly long and complex. We are also mindful of the dangers of the other unintended consequences noted by commenters.

At the same time, we remain convinced that clear information about product costs, the use of proprietary products and limitations on the products or services that will be made available to clients are important to client's understanding of what to expect from the relationship with their registrant.

We therefore revisited our proposals for RDI and re-focused them on the elements that we believe will make a real difference for clients. The Proposed Amendments require firms to provide the listed information, but we no longer propose prescriptive detail. Consistent with the Proposed Amendments regarding KYP, firms would not be required to categorize themselves as "proprietary" or "mixed/non-proprietary." Firms would only have to tell each client if their account will consist primarily or exclusively of proprietary products (this essentially carries forward guidance added to the Policy Statement in 2017). Firms would have to tell each client about any restrictions on the products or services that would be provided to them. Firms would have to explain the impact charges, ongoing product fees and restrictions on products or services might have on a client, but can exercise professional judgment as to how best to do that in the circumstances, provided some basic guidance added to the Policy Statement is taken into account.

Our expectations for clear, meaningful and above all, not misleading, communications with clients are stressed with additions to the guidance in the Policy Statement. This is found both in the sections concerning RDI guidance and in proposed new Part 13, Division 7 [*Misleading communications*].