

**CSA Notice of Publication**

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

*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)**

October 3, 2019

**Introduction**

The Canadian Securities Administrators (the **CSA** or **we**) are adopting amendments (the **Amendments**) to *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**Regulation 31-103**) and *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the **Policy Statement**, together the **Regulation**).

The Amendments are relevant to all categories of registered dealer and registered adviser, with some application to investment fund managers.

The Amendments have been or are expected to be adopted by each member of the CSA.

The Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association of Canada (**MFDA**) (together, referred to as the **self-regulatory organizations** or **SROs**) have participated in the development of the Amendments. We expect the SROs to amend their respective member rules, policies and guidance to be uniform with the Amendments in all material respects. When that process is complete, corresponding amendments will be made to the exemptions for SRO members in Part 9 of Regulation 31-103.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Provided all ministerial approvals are obtained, the Amendments will come into force on December 31, 2019. Implementation of the Amendments will be subject to a transition provision discussed below.

## Substance and Purpose

The Amendments implement the Client Focused Reforms (**CFRs**) which make changes to the registrant conduct requirements in order to better align the interests of securities advisers, dealers and representatives (**registrants**) with the interests of their clients, improve outcomes for clients, and make clearer to clients the nature and the terms of their relationship with registrants.

The CFRs are based on the concept that in the client-registrant relationship, the interests of the client come first. Under the Amendments, registrants will be required to

- address material 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.

These core elements of the Amendments are supported with the introduction of a know your product (**KYP**) provision in Regulation 31-103 and enhancements to the existing know your client (**KYC**), suitability, conflict of interest, and relationship disclosure information (**RDI**) requirements. 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 for the duty of registrants to deal fairly, honestly and in good faith with their clients.

The Amendments to the KYC requirements are needed to support the enhanced suitability determination obligations. The new KYP requirements set out firm and registered individual obligations that support the enhanced suitability determination obligation and the enhanced conflicts of interest requirement. Amendments to the conflicts of interest provisions support the new obligation to address conflicts in the client's best interest with requirements for registered firms and registered individuals concerning the identification and disclosure of material conflicts. The Amendments to the RDI requirements include requirements to inform clients about potentially significant restrictions, costs and limitations relating to the products and service offered to them. There are also new provisions concerning misleading communications. Finally, the Amendments include additions to internal controls and a requirement for firms to provide training to their registered individuals. The Amendments also include some technical, non-substantive consistency changes to the Regulation.

Some of the Amendments will impose new requirements, while others codify best practices set out in existing CSA and SRO guidance. We believe that, taken together, they will result in a new, higher standard of conduct across all categories of registered dealer and registered adviser.

Annex A – *Summary of changes to the Regulation* describes the key changes to Regulation 31-103 and the Policy Statement in more detail.

## **Background**

The CFRs were developed over the course of an extensive consultation process.

### ***Publication for Comment***

We published proposed amendments for comment on June 21, 2018 (the **Proposals**). In the Amendments, we have made changes to certain of the Proposals. These changes are summarized below and discussed in Annex A and Annex B – *Summary of comments on the Proposals and responses*. As these changes are not material, we are not publishing the Amendments for another comment period.

### ***Earlier Consultation Process***

The Amendments were developed after an extensive consultation process, including 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* (2012) and CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* (2016), among other publications, as well as public consultation meetings held in some CSA member jurisdictions.

### ***Further Reforms***

We intend to develop and propose for comment additional reforms relating to some of the proposals discussed in the consultations leading up to the Proposals. These are separate, longer-term projects. They may include:

- reviewing proficiency standards;
- imposing a statutory fiduciary duty when a client grants discretionary authority in those jurisdictions which do not currently have this provision;
- clarifying the role of ultimate designated persons and chief compliance officers;
- reviewing titles and designations;
- reviewing referral arrangements;
- revisiting the provision, originally included in the Proposals, relating to publicly available information.

## **Summary of Written Comments Received by the CSA**

During the comment period, we received submissions from 135 commenters. We have considered the comments received and thank all of the commenters for their input. A summary of comments together with our responses is set out in Annex B. The names of commenters are contained in Annex C – *List of commenters*.

Copies of the comment letters were posted on the following websites:

- the Alberta Securities Commission at [www.albertasecurities.com](http://www.albertasecurities.com)
- the Autorité des marchés financiers at [www.lautorite.qc.ca](http://www.lautorite.qc.ca)
- the Ontario Securities Commission at [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

## **Summary of Changes to the Proposals**

In developing the Amendments, we carefully reviewed the comments that we received on the Proposals. Public comments make a valuable contribution to the rulemaking process. This includes finding the right balance between achieving regulatory goals and the associated burdens. We found some of the comments recommending changes to be persuasive and revised the Proposals accordingly. We believe we have achieved an appropriate balance, keeping the core elements of the CFRs intact after streamlining the Proposals to remove obstacles to effectively operationalizing them. Ultimately, these measures will help achieve the investor protection goals of the CFRs.

Among the more notable changes, which are summarized below, we have,

- added a materiality qualifier in the conflicts of interest provisions,
- removed prescriptive restrictions on referral arrangements,
- removed the proposed new provision for publicly available information, and
- made changes to parts of Regulation 31-103 and added guidance in the Policy Statement to help registered firms to scale the CFRs to their particular operations.

In addition to these notable changes, the Amendments also include other changes to Regulation 31-103 and revisions to the guidance in the Policy Statement, which are primarily intended to clarify the interpretation of the new requirements.

The changes to the Proposals and our reasons for making them are discussed in more detail in Annex B.

### ***Referral arrangements***

- We removed the proposed restrictions on referral arrangements and referral fees (existing requirements relating to referral arrangements remain in place and the enhanced standard for conflicts of interest will apply to referral arrangements).

### ***Publicly available information***

- We removed the proposed requirement to make certain information publicly available.

### ***Conflicts of Interest***

- We added a materiality threshold with respect to conflicts of interest, and guidance to explain when a conflict of interest is “material”.
- We removed the proposed prohibitions on acting as a power of attorney or trustee for clients.

### ***Suitability***

- We removed certain proposed suitability assessment factors from the express list in Regulation 31-103 requirement, addressing them, instead, with guidance in the Policy Statement, including

- the features and associated costs of the account type made available to the client, and
  - the overall concentration and liquidity across all of the client's accounts at the firm.
- We removed the proposal to include “any other factor that is relevant under the circumstances”.
  - We expanded the existing exemption for permitted clients so that non-individual permitted clients can waive suitability determinations for managed accounts.
  - We removed proposed guidance suggesting that a registrant should inquire about a client's other investments or holdings held elsewhere in order to inform the registrant's suitability determination.
  - We also removed the proposed statement in the Policy Statement that “Unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1)”.

#### ***KYC***

- We removed the proposed Regulation 31-103 requirement to update KYC if the registrant reasonably ought to know of a significant change in the client's information (the requirement will still apply if the registrant becomes aware of a significant change).
- We made the KYC gathering exemption for non-individual permitted clients consistent with the expanded exemption in the suitability provisions.
- We added Policy Statement guidance to clarify how the KYC requirements can apply to registrants' different business models.

#### ***KYP***

- We added Policy Statement guidance to more fully address the scalability of the KYP requirements, depending on the nature and complexity of the securities involved.
- We removed the following from the proposed Regulation 31-103 changes:
  - the requirement that a registered firm must perform a comparison between the securities it makes available to clients and other similar securities in the market;
  - prescriptive requirements in respect of securities transferred in (instead, we explain in guidance that registrants must take reasonable steps to

understand transferred in securities within a reasonable time after their transfer);

- the requirement that a registered firm must monitor and reassess a security (firms are only required to monitor for significant changes);
- the requirement that registered individuals must take reasonable steps to understand, at a general level, each type of security available to clients, and how those securities compare;
- the requirement that a registered firm must maintain an offering of securities and services that is consistent with how the firm holds itself out (instead, we discuss holding out in the guidance relating to misleading communications);
- the requirement that a registrant must understand the returns of a security (the Policy Statement guidance notes that under the KYP provisions, registrants should understand the *basis* of the security's return, among other factors).

### ***RDI***

- We clarified that the required discussion of any limitations on products and services offered to a client is only required to be at a *general* level.
- We expanded the requirement to provide a general description of the products or services a registered firm will offer to clients in order to make it clear that the description must include reference to any restrictions on the client's ability to liquidate or resell a security.
- We removed restrictions on the products offered to a client (such as only offering proprietary products) from the impacts that must be discussed with clients.
- We clarified that the required discussion of impacts of fees and charges on a client's investment returns is only required to be at a *general* level and relates to *potential* impacts.

### **Transition**

We are providing for a phased transition period, with the Amendments relating to conflicts of interest and the associated RDI provisions taking effect on December 31, 2020, and the remaining Amendments taking effect on December 31, 2021. Registrants will have to comply with the applicable Amendments after those dates. There are no grandfathering provisions.

We will establish an implementation committee to provide guidance, respond to questions and otherwise assist registrants to operationalize the Amendments.

We wish to make it clear that it is not our expectation that current registrants would have to update all existing clients' KYC information and reassess the suitability of their investments as of the effective date of the relevant Amendments (December 31, 2021) or immediately after that date. We would expect registrants to continue to schedule reassessments in accordance with current requirements up until then, and to schedule reassessments in accordance with the triggers in the Amendments after that date.

## **Local Matters**

An annex includes, where applicable, additional information that is relevant in a local jurisdiction only.

## **List of Annexes**

This notice contains the following annexes:

- *Annex A – Summary of changes to the Regulation*
- *Annex B – Summary of comments on the Proposals and responses*
- *Annex C – List of commenters*
- *Annex D – Adoption of the Amendments*

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

[www.lautorite.qc.ca](http://www.lautorite.qc.ca)

[www.albertasecurities.com](http://www.albertasecurities.com)

[www.bcsc.bc.ca](http://www.bcsc.bc.ca)

[www.fcnb.ca](http://www.fcnb.ca)

[nssc.novascotia.ca](http://nssc.novascotia.ca)

[www.osc.gov.on.ca](http://www.osc.gov.on.ca)

[www.fcaa.gov.sk.ca](http://www.fcaa.gov.sk.ca)

[www.msc.gov.mb.ca](http://www.msc.gov.mb.ca)

## **Questions**

Please refer your questions to any of the following:

Martin Picard

Analyste expert à l'encadrement des intermédiaires

Direction de l'encadrement des intermédiaires

Autorité des marchés financiers

514 395-0337 and 1 877 525-0337

[martin.picard@lautorite.qc.ca](mailto:martin.picard@lautorite.qc.ca)

Sophie Jean  
Directrice de projets  
Direction de l'encadrement des intermédiaires  
Autorité des marchés financiers  
514 395-0337 and 1 877 525-0337  
[sophie.Jean@lautorite.qc.ca](mailto:sophie.Jean@lautorite.qc.ca)

Sandrine Siewe  
Analyste  
Direction de l'encadrement des intermédiaires  
Autorité des marchés financiers  
514 395-0337 and 1 877 525-0337  
[sandrine.siewe@lautorite.qc.ca](mailto:sandrine.siewe@lautorite.qc.ca)

Isaac Filaté  
Senior Legal Counsel  
Capital Markets Regulation  
British Columbia Securities Commission  
604 899-6573 and 1 800 373-6393  
[ifilate@bcsc.bc.ca](mailto:ifilate@bcsc.bc.ca)

Bonnie Kuhn  
Senior Legal Counsel  
Market Regulation  
Alberta Securities Commission  
403 355-3890  
[bonnie.kuhn@asc.ca](mailto:bonnie.kuhn@asc.ca)

Liz Kutarna  
Deputy Director, Capital Markets  
Securities Division  
Financial and Consumer Affairs Authority of Saskatchewan  
306 787-5871  
[liz.kutarna@gov.sk.ca](mailto:liz.kutarna@gov.sk.ca)

Chris Besko  
Director, General Counsel  
The Manitoba Securities Commission  
204 945-2561 and 1 800 655-5244  
(Toll Free (Manitoba only))  
[chris.besko@gov.mb.ca](mailto:chris.besko@gov.mb.ca)



Debra Foubert  
Director, Compliance and Registrant Regulation  
Ontario Securities Commission  
416 593-8101  
[dfoubert@osc.gov.on.ca](mailto:dfoubert@osc.gov.on.ca)

Chris Jepson, Senior Legal Counsel  
Ontario Securities Commission  
416 593-2379  
[cjepson@osc.gov.on.ca](mailto:cjepson@osc.gov.on.ca)

Erin Seed, Senior Legal Counsel  
Ontario Securities Commission  
416 596-4264  
[eseed@osc.gov.on.ca](mailto:eseed@osc.gov.on.ca)

Kat Szybiak, Senior Legal Counsel  
Ontario Securities Commission  
416 593-3686  
[kszybiak@osc.gov.on.ca](mailto:kszybiak@osc.gov.on.ca)

Chris Pottie  
Deputy Director, Registration & Compliance, Nova Scotia Securities Commission  
902 424-5393  
[chris.pottie@novascotia.ca](mailto:chris.pottie@novascotia.ca)

Steven Dowling  
Acting Director  
Consumer, Labour and Financial Services Division  
Justice and Public Safety  
Government of Prince Edward Island  
902 368-4551  
[sddowling@gov.pe.ca](mailto:sddowling@gov.pe.ca)

Jason Alcorn  
Senior Legal Counsel and Special Advisor to the Executive Director  
Financial and Consumer Services Commission of New Brunswick  
506 643-7857  
[jason.alcorn@fcnb.ca](mailto:jason.alcorn@fcnb.ca)

John O'Brien  
Superintendent of Securities  
Service NL  
Government of Newfoundland and Labrador  
709 729-4909  
[johnobrien@gov.nl.ca](mailto:johnobrien@gov.nl.ca)

Jeff Mason  
Director of Legal Registries  
Department of Justice, Government of Nunavut  
867 975-6591  
[jmason@gov.nu.ca](mailto:jmason@gov.nu.ca)

Thomas Hall  
Superintendent of Securities  
Department of Justice  
Government of the Northwest Territories  
867 767-9305  
[tom\\_hall@gov.nt.ca](mailto:tom_hall@gov.nt.ca)

Rhonda Horte  
Deputy Superintendent  
Office of the Yukon Superintendent of Securities  
867 667-5466  
[rhonda.horte@gov.yk.ca](mailto:rhonda.horte@gov.yk.ca)

## ANNEX A

### SUMMARY OF CHANGES TO THE REGULATION

This annex summarizes the changes that the Amendments will make to the current versions of Regulation 31-103 and the Policy Statement. In addition to the changes summarized in this annex, the Amendments also include technical drafting changes and clarifications.

#### ***Exemptions***

The following exemptions will continue in effect or have been expanded:

- certain KYC requirements and the suitability determination obligation do not apply in respect of certain permitted clients if they have consented;
- suitability and related KYC requirements do not apply to registrants dealing with clients in the context of order-execution-only services (which are subject to IIROC member rules), or to trades directed by portfolio managers;
- investment fund managers are exempted from the following provisions, unless they are acting under an additional registration in a dealer or adviser category
  - KYC,
  - KYP, and
  - suitability determination;
- conflicts of interest obligations set out in sections 13.4 and 13.4.1 do not apply to investment fund managers in respect of investment funds that are subject to *Regulation 81-107 respecting Independent Review Committee for Investment Funds*.

#### ***Custody obligations for mutual fund dealers registered in Québec – Part 9 [Membership in an SRO],***

For clarity, we are adding provisions to section 9.4 to the effect that mutual fund dealers registered in Québec that are MFDA members may rely on certain of the exemptions for MFDA members in subsections 9.4(1) and (2) relating to custody of assets, provided the registered firm complies with the corresponding MFDA provisions.

#### ***Internal controls and systems – Part 11***

The Amendments include changes to the requirements for training and record-keeping corresponding to the new and enhanced requirements in respect of KYC, KYP, suitability determinations and conflicts of interest.

- Section 11.1 [*Compliance system and training*] is expanded to require registered firms to provide training to their registered individuals on compliance with securities legislation, including
  - the KYC, KYP and suitability determination obligations, and

- conflicts of interest requirements.
- Section 11.5 [*General requirements for records*] is expanded to include requirements for
  - 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 and incentive practices, and
    - other compensation arrangements and incentive practices which may benefit the firm, its registered individuals or any affiliate or associate of the firm, and
  - demonstrating compliance with requirements relating to misleading communications.

We have added some guidance in the Policy Statement setting out our expectations concerning firms' training programs, particularly with respect to the addressing of conflicts of interest in the best interests of their clients, as well as guidance concerning policies and procedures relating to the new record-keeping requirements.

### ***KYC – section 13.2***

The Amendments expand the KYC requirements in section 13.2 [*Know your client*] to support the enhanced suitability determination requirement by clarifying the content and scope of the KYC process.

- 13.2(2)(c) – expands the list of 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 additional information required includes the client's
  - personal circumstances (not limited to financial circumstances),
  - investment knowledge,
  - risk profile (guidance clarifies that this includes both the client's risk tolerance and their risk capacity), and
  - 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.
- 13.2(4) – expands requirement to keep KYC information current to expressly require updating the client's information if the registrant become aware of a significant change.
- 13.2(4.1) – new subsection specifying minimum intervals when a client's KYC information must be reviewed:

- 12 months for managed accounts;
  - 12 months before making a trade or recommendation for exempt market dealers;
  - 36 months for other cases.
- New guidance in the Policy Statement discusses, among other things,
    - the ways a registrant may tailor its KYC process to reflect its business model and the nature of its relationships with clients,
    - using technology for the collection of KYC information, and
    - our expectations with respect to the KYC information that must be collected by registrants to meet the requirements in Regulation 31-103 on an ongoing basis.

***KYP – new section 13.2.1***

There is currently no explicit Regulation 31-103 requirement concerning KYP, while the Policy Statement currently provides only limited principles-based guidance on our KYP expectations in the context of the proficiency and suitability requirements. The Amendments introduce an express KYP Regulation 31-103 requirement in new section 13.2.1 [*Know your product*]. Like the enhanced KYC requirements, this is intended to support an enhanced suitability determination obligation.

- 13.2.1(1) – obligation of registered firms to take reasonable steps to ensure that the securities that they make available to clients are
  - assessed with regard to their relevant aspects, including for their structure, features, risks, initial and ongoing costs, and the impact of those costs,
  - approved to be made available to clients, and
  - monitored for significant changes.
- 13.2.1(2) – obligations of registered individuals to take reasonable steps to understand the securities that they purchase, sell or recommend to a client, including the impact of the initial and ongoing costs associated with acquiring and holding each security, sufficient to enable them to make a suitability determination.
- 13.2.1(3) – registered individuals must only purchase or recommend securities approved by their firm to be made available to clients.

The Policy Statement codifies our KYP expectations of firms and registrants as set out in previous CSA and SRO guidance. It also sets out our views on how firms can tailor their processes for meeting the KYP obligation depending on

- a firm’s business model,
- a security’s type,
- whether other registrants are also involved in a security’s distribution to the client, and
- whether a security is being transferred in.

### ***Suitability determination – section 13.3***

The Amendments enhance the suitability determination obligation in section 13.3 [*Suitability determination*] with, among other things, a new core requirement that registrants must put their clients' interests first when making a suitability determination.

- 13.3(1) – current suitability requirement replaced with new subsection providing that before a registrant opens an account for a client, purchases, sells, deposits, exchanges or transfers securities for a client's account, takes any other investment action for a client, or makes a recommendation or exercises discretion to take any such action, the registrant must determine, on a reasonable basis, that
  - the action is suitable for the client, based on the following factors:
    - KYC information;
    - the registrant's assessment or understanding of the security;
    - the impact of the action on the account, including its concentration and liquidity;
    - the actual and potential impact of costs on the client's returns;
    - a reasonable range of alternatives available through the firm at the time the determination is made; and
  - the action 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, within a reasonable time, in the following circumstances:
  - a registered individual is designated as responsible for the client's account;
  - the registrant becomes aware of a change in a security in the account, or becomes aware of a change in the client's KYC information, that could result in the security or account not satisfying the suitability determination criteria;
  - the registrant has undertaken a review of the client's KYC information.
  
- 13.3(2.1) – new subsection replacing the current provision for client-directed trades.

New guidance in the Policy Statement sets out our expectations as to how registrants may meet their enhanced suitability obligations. We clarify that if we review a suitability determination made by a registrant, we will do so without hindsight and on the basis of what a reasonable registrant would have done under the same circumstances.

### ***Waivers – section 13.3.1***

New section consolidating exemptions from certain KYC requirements and the suitability determination obligation in respect of certain permitted clients if they consent.

### ***Conflicts of interest – Part 13: Division 2***

The Amendments to the conflicts of interest requirements in Part 13: Division 2 [*Conflicts of interest*], among other things, introduce a new requirement that material conflicts must be addressed in the best interest of the client.

- 13.4 [*Identifying, addressing and disclosing material conflicts of interest – registered firm*] – revised and new requirements requiring a registered firm to
  - identify existing and reasonably foreseeable material conflicts of interest between a client and the firm or any individual acting on the firm’s behalf,
  - address all material conflicts of interest in the best interest of the client,
  - avoid material conflicts of interest that cannot be otherwise addressed in the best interest of the client, and
  - provide affected clients with disclosure of material conflicts of interest at account opening or in a timely manner if they are identified later.
- In each case, the disclosure must be prominent, specific and written in plain language, specifying
  - the nature and extent of the conflict of interest,
  - the potential impact on and risk that it may pose to the client, and
  - how it has been, or will be, addressed.
- It is expressly stated that a registrant cannot satisfy its obligations to identify and address material conflicts of interest *solely* by providing disclosure to the client.
- 13.4.1 [*Identifying, reporting and addressing material conflicts of interest – registered individual*] – new and revised sections with similar effect to section 13.4, except that registered individuals must promptly report conflicts of interest to their sponsoring firm (disclosure to the client is the firm’s responsibility).
- 13.12 [*Restriction on borrowing from, or lending to, clients*] – revisions
  - expanding the exemptions from the prohibition on lending money to clients, and
  - adding a new prohibition on borrowing money from clients, subject to certain exemptions.

Expanded guidance in the Policy Statement discusses our expectations of how registrants can implement the conflicts of interest requirements, including examples of controls that registered firms can consider putting in place for these purposes.

### ***Misleading communications – Part 13: Division 7***

The Amendments add a new section 13.18 [*Misleading communications*] providing that

- A registrant must not hold themselves out in any manner that could reasonably be expected to deceive or mislead any person as to:
  - their proficiency, experience, qualifications or category of registration;

- the nature of the person’s relationship, or potential relationship, with the registrant;
- the products or services provided, or to be provided by the registrant.
- a registered individual who interacts with clients must not use any of:
  - a title, designation, award, or recognition that is based partly or entirely on that registrant’s sales activity or revenue generation;
  - a corporate officer title unless their sponsoring firm has appointed that registrant to that corporate office pursuant to applicable corporate law;
  - a title or designation unless their sponsoring firm has approved the use.

Related guidance is set out in the Policy Statement.

***RDI – section 14.2***

The Amendments include changes to the requirements in section 14.2 [*Relationship disclosure information*] to maintain consistency with the new and enhanced requirements, and to better implement the principle in subsection 14.2(1) 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”.

- 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 requirements to include (as may be applicable)
  - restrictions on the client’s ability to liquidate or resell a security, and
  - investment fund management expense fees or other ongoing fees the client may incur.
- 14.2(2)(b.1) – new requirement for a general description of any limits on the selection of the products or services the registrant will offer to the client, including
  - whether the firm will primarily or exclusively use proprietary products in the client’s account, and
  - whether there will be any other limits on the selection of the products or services.
- 14.2(2)(k) – current requirement for disclosure of the obligation to make suitability determinations revised to make it conform with the enhanced suitability determination Amendments.
- 14.2(2)(l) – drafting revision to remove ambiguity and clarify regulatory intent consistent with existing guidance in the Policy Statement.



- 14.2(2)(o) – new requirement to provide a general explanation of the potential impact of each of
  - operating charges,
  - transaction charges,
  - investment fund management expense fees, and
  - other ongoing fees the client may incur.
  
- 14.2.1 [*Pre-trade disclosure of charges*] – requirement for pre-trade disclosure expanded to expressly require investment fund management expense fees or other ongoing fees that the client may incur, building on existing Policy Statement guidance regarding pre-trade disclosure regarding mutual funds and the information included in the fund facts document required to be delivered at point-of-sale.

Related guidance is included in the Policy Statement.

## ANNEX B

### SUMMARY OF COMMENTS ON THE PROPOSED AMENDMENTS AND RESPONSES

This annex summarizes the written public comments we received on the Proposed Amendments and our responses to those comments. Out of the 135 comment letters we received, 117 were from industry stakeholders (including registrants, industry associations and law firms), and 18 were from non-industry stakeholders (including investors, investor advocates, academics and others).

This annex contains the following sections:

1. General comments and responses
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 conflicts of interest proposals
6. Comments and responses on the referral arrangement proposals
7. Comments and responses on the RDI proposals
8. Comments and responses on other proposals
  - Firm's obligation to provide training
  - Misleading communications
  - Record keeping requirements

#### 1. General comments and responses

##### *Balance of costs and benefits*

Many industry commenters expressed concerns that implementing the Proposed Amendments would impose costs on them that would be greater than the benefits, if any, to investors. We recognize that, for some registrants, there will be significant costs associated with implementing the Amendments. We are mindful of the need to strike an appropriate balance and view public comments as an important part of the process of gauging costs and benefits, allowing us to recalibrate proposals before bringing new requirements forward. We have responded to the comments on the Proposed Amendments by making a number of changes that are designed to address key concerns about costs without compromising the benefits we intend for investors.

We do not agree with commenters who said that an emphasis on enforcing existing requirements would be a sufficient alternative to the CFRs. We continue to believe the Amendments are necessary and we believe that, with the revisions we have made, they strike an appropriate balance between costs and benefits. Nor do we agree with those commenters who asserted that a variety of unintended consequences will result if we implement the CFRs, particularly now that the Proposed Amendments have been re-worked into the form of the Amendments. We also disagree with those who called for more consultations before proceeding with the CFRs, given the extent of consultations beginning six years before the publication of the Proposed Amendments.

Lastly, we note that while some of the CFRs would impose new conduct requirements on registrants, others codify best practices set out in existing CSA and SRO guidance. One objective is to reduce the potential for regulatory arbitrage across registration categories and business models. Registrants that already follow such best practices and those that already conduct themselves as fiduciaries should be relatively less affected than others.

### ***Scalability***

Industry commenters also expressed concerns that the Proposed Amendments take a “one-size-fits-all” approach. They argued that there should be a greater allowance for firms to tailor the CFRs to fit their specific business models, products and services and the different types of clients that they serve. We acknowledge these comments and have made changes to the Policy Statement to address scalability in light of different business models.

### ***Exempt market dealers (EMDs)***

In the Notice of publication of the Proposed Amendments, we specifically invited comment on the question:

“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?”

Commenters indicated that exempt market dealers may indeed be a special case where they have transactional or episodic relationships with their clients, and also because they often distribute illiquid securities of small issuers. In view of these comments, we have considered whether tailored exemptions for EMDs would be warranted. However, we have concluded that the approach described under the heading *Scalability* is sufficient.

### ***Overly prescriptive guidance***

Some industry commenters felt that the Policy Statement guidance is overly prescriptive, lacks allowances for deference by regulators to the professional judgment of registrants, and appears to impose substantive requirements. We have reviewed the proposed guidance with this in mind and have made adjustments to ensure that the guidance does not purport to impose prescriptive requirements and, where appropriate, we have acknowledged the role of professional judgement. We have balanced these changes with the need to provide useful guidance to the industry professionals seeking to apply Regulation 31-103 requirements, which are often principles-based, to their firms’ operations.

### ***The “best interest” and “client’s interest first” standards***

Some commenters, chiefly investor advocates, expressed their disappointment with the abandonment of the overarching best interest standard which some CSA members had explored in consultations prior to the publication of the Proposed Amendments. However, in the absence

of an explicit standard, they expressed support for the harmonized approach that infuses the client's best interest into the conflicts of interest and suitability reforms.

Many industry commenters expressed support for drawing back from the overarching best interest standard. However, they were often concerned about the implications of the requirements to "put the client's interest first" in making suitability determinations and to address conflicts of interest "in the client's best interest", including what distinction there might be between these standards, and between them and a fiduciary standard.

In our view, to put the client's interest first and to address *conflicts of interest* in the best interest of the client mean that the interests of the client are paramount. A registered firm and its registered individuals must put the interests of their clients first, ahead of their own interests and any other competing considerations. In the enhanced *suitability determination* requirement, we specifically used the words "put the client's interest first" to signal that there is not necessarily only one "best" course of action. We have included related guidance in the Policy Statement.

We stress that the Amendments do not impose a fiduciary duty on registrants as a regulatory standard of conduct. Of course, it will continue to be within the purview of the courts to determine whether a common law fiduciary duty applies in the circumstances of private claims by clients against registrants<sup>1</sup>.

### ***SRO harmonization***

Some commenters asked that the new requirements be harmonized across the CSA and the self-regulatory organizations in order to enhance their enforceability and make it easier to operationalize them where affiliated firms registered in different categories share common platforms. Commenters also suggested that the Proposed Amendments be informed by existing SRO guidance as they are well understood and recognizable standards.

The SROs have participated in the development of the Amendments, which have been informed by member rules, policies and guidance. It is our intention that the SROs will amend their respective member rules, policies and guidance to be uniform with the Amendments in all material respects.

### ***Level playing field***

We received comments that the CFRs would result in an uneven playing field for registered firms, as investment products that do not fall under the jurisdiction of the CSA will not be subject to comparable requirements.

We acknowledge the comment but can only make rules within our jurisdiction. The fact that other segments of the financial industry will not, at the same time, have comparable requirements for non-securities investments does not mean that we should not regulate to the level necessary for those who invest in securities.

---

<sup>1</sup> In Québec, where the common law regime does not apply, the extent of a registrant obligations is subject to the Civil Code of Québec.

## ***Enforcement***

Many commenters emphasized that effective enforcement of the rules will be important to ensure effectiveness of the CFRs. We agree. Many commenters sought further assurance that the CSA will not adjudicate a registrant's decision in hindsight or supplant its judgment in place of the registrant. We have added guidance on this topic in the Policy Statement.

## ***Exemptions***

We received comments seeking certain exemptions from the CFRs.

### **Non-individual permitted clients**

Many commenters suggested exempting registrants from the CFRs when dealing with non-individual permitted clients, including their managed accounts, given their sophisticated investment knowledge, focused investment objectives with each registrant, and ability to contract for the protections they expect. At minimum, the commenters asked that non-individual permitted clients be able to waive some of the proposed requirements.

We do not agree with the suggestion that non-individual permitted clients should be carved out of the CFRs to a greater extent than is contemplated in the exemptions already provided in Regulation 31-103. However, we have expanded existing exemptions so that non-individual permitted clients may now waive suitability determinations and the gathering of KYC information to support suitability determinations for managed accounts.

### **Portfolio managers**

Some commenters expressed the view that portfolio managers (**PMs**) with discretionary authority should be exempted from the enhanced conflicts of interest, suitability and KYP requirements as they are already subject to high proficiency requirements and a fiduciary duty, and since they do not deal with "products" in the same way as other registrants.

While we believe that many PMs will find that the Amendments are to a large extent a codification of their best practices and therefore relatively easy to operationalize, we do not think that there is a persuasive case to exempt them from the application of the Amendments, which operate as baseline requirements.

### **Scholarship plan dealers**

Given their business models, scholarship plan dealers asked to be excluded from the enhanced requirements and be afforded the ability to tailor the process to reflect their business models and the nature of their relationships with clients. For example, they believe that requiring them to update KYC information at regular intervals or to reassess suitability would be onerous and without any benefit to the client or the dealer given the nature of scholarship plans.

See our response to comments under the heading *Scalability*.

### Order Execution Only (OEO) firms

Many commenters suggested exempting OEO (i.e., “discount brokerage” specialist) firms from the CFRs. Since they do not provide recommendations to their clients, some of the proposed new requirements would be unnecessary in the circumstances.

OEO firms are registered as investment dealers and, as such, subject to IIROC member rules, which include express provisions for their unique operating model. This will continue after the implementation of the Amendments, with appropriate changes being made to IIROC member rules. Part 9 of Regulation 31-103 includes certain exemptions for any registered investment dealer that is in compliance with equivalent requirements in member rules. This will also continue to be the case after the implementation of the Amendments.

With respect to requirements where IIROC members are not exempted under Part 9, see our comments under the heading *Scalability*.

For registered dealer firms that execute trades as directed by advisers, which they may do without necessarily being OEO firms, the Amendments include exemptions from suitability and related KYC and KYP requirements.

### *Transition period*

In the Proposed Amendments, we proposed the following phased implementation schedule for the CFRs:

- 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, and
- KYC, KYP, suitability and conflicts of interest – 2 years.

In order to implement the CFRs, registered firms will need to review and amend their compliance systems, including making changes to their policies, procedures and controls to address material conflicts of interest in the best interest of their clients, and to establish a framework where the registrants put the client’s interest first when making suitability determinations, and they will also need to train their registered representatives, all according to the scale of their operations.

We are not proceeding with the proposed amendments to referral arrangements and the proposal on providing publicly available information. As concerns the remaining provisions, we have carefully reviewed the comments on the proposed transition periods, which can be summarized as follows:

- many industry commenters felt that more time would be needed given the magnitude and impact of the Proposed Amendments, which will require significant changes to processes,

systems, tools, and training programs – those making these comments suggested a minimum of three years;

- other commenters, including investor advocates, were of the opinion that the proposed transition periods were too long;
- there were also suggestions that the implementation period should not begin until after the SROs have modified their member rules to align with the CFRs;
- a few commenters sought clarity on whether the reforms will apply on a go-forward basis or whether the rules will take effect as of a certain date without any grandfathering.

In light of the importance of the CFRs, we are providing for a phased transition period, with the Amendments relating to conflicts of interest and the associated RDI provisions taking effect on December 31, 2020, and the remaining Amendments taking effect on December 31, 2021.

While we recognize the significant work many registrants will need to undertake to implement the CFRs, we are of the view that these periods will be sufficient. To help registrants implement the CFRs effectively and on time, we intend to establish an implementation committee to provide guidance, respond to questions and otherwise assist registrants to operationalize the Amendments.

### ***Interaction with Regulation 81-105 respecting Mutual Fund Sales Practices***

Some commenters asked for clarification on how the CFRs are intended to interact with the existing requirements in *Regulation 81-105 respecting Mutual Fund Sales Practices (Regulation 81-105)*. Some commenters suggested that the CSA should consider expanding Regulation 81-105 to apply to all securities rather than just mutual funds. Other commenters suggested carving out mutual fund sales practices from the application of conflict of interest requirements in the CFRs.

A separate project on the treatment of certain embedded fees arising in connection with mutual fund sales is presently being undertaken by the CSA. The results of this work may be incorporated into the CFRs in the future.

### ***Drafting suggestions***

We received a number of drafting suggestions and comments. While we incorporated some of these suggestions, this summary does not include a detailed list of all of the drafting changes we made.

### ***Topics outside the scope of the CFRs***

We have not provided responses to the comments we received on topics that are outside the scope of the CFR project, including:

- changing the definition of permitted client;

- titles, designations and proficiency standards;
- regulation of financial planners;
- investor education and outreach;
- dispute resolution and the Ombudsman for Banking Services and Investments;
- cost and performance reporting;
- investor restitution;
- section 160.1.1 of the *Securities Act* (Québec) on commission sharing by mutual fund dealers and scholarship plan dealers.

## 2. Comments and responses on the KYC proposals

### *“Thorough understanding” versus “meaningful understanding”*

Many commenters sought clarification on the terms “thorough understanding” and “meaningful understanding” which were used in the proposed guidance. Some commenters suggested that the term “thorough understanding” is too onerous and imposes a higher standard than Regulation 31-103 requires.

We have revised the Policy Statement to address these concerns by deleting those terms and clarifying that the registrant’s KYC process should result in the registrant having sufficient understanding of its clients to be able to discharge its suitability determination obligations.

### *Scalability of KYC requirements*

Most industry commenters viewed the proposed enhanced KYC requirements as being too prescriptive and indicated that the information to be collected should be scalable and limited to what is necessary to provide a suitable investment recommendation, given the registrant’s business model, client type, and products and services offered. Some commenters asked the CSA to provide guidance on how to tailor the KYC process.

We agree that KYC should be scalable, applying the principle that a registrant’s KYC process should result in the registrant having *sufficient understanding* of its clients to be able to discharge its suitability determination obligations. To respond to the comments, we have removed some of the more prescriptive elements in the Policy Statement and clarified certain provisions from the KYC Proposal to make it clearer that the registrant’s KYC obligation is scalable and technology neutral.

The guidance now states that although Regulation 31-103 sets out a list of factors that a registrant must take into consideration in order to obtain sufficient KYC information, the depth of the enquiries that a registrant must make with regard to a client will vary and should be tailored depending on the securities and services offered to the client, the firm’s business model



and the nature of the relationship with the client. We give examples of different operating models that we believe would warrant different levels of KYC enquiry.

### ***Meaningful interaction with the client***

Some commenters asked for clarity on what it means to have a “meaningful interaction with the client,” particularly when dealing with clients via non-face-to-face channels, including online advisers.

The CFRs preserve the technology-neutral stance of Regulation 31-103, in line with previous notices, such as CSA Staff Notice 31-342 *Guidance for Portfolio Managers Regarding Online Advice*. We have clarified the Policy Statement to explain that tools such as standardized questionnaires may be used to collect or review the KYC information, *as long as the process amounts to a meaningful interaction between the client and the registrant* (i.e., an actual conversation is not necessarily required). Ultimately, the registrant remains responsible for the process regardless of the tools or technologies it uses.

### ***Reluctance by clients to provide prescribed KYC information***

Many industry commenters raised concerns that clients would be reluctant to provide some of the prescribed information (for example, their personal or financial circumstances), and that clients should be able to refuse to provide certain information. The commenters also asked the CSA to clarify what the registrant was required to do when the client refuses to provide the prescribed KYC information.

This is not a concern unique to the CFRs – registrants face this challenge under current requirements. We have added guidance in the Policy Statement to explain that the refusal of a client to provide or update all of the information requested by a registrant does not automatically prevent the registrant from servicing the client. We set out our expectation that registrants will use their professional judgment to consider whether they have collected enough information to meet their suitability determination requirements, and whether the information remains sufficiently current. Registrants should also consider restricting activities in the account of clients where they have determined they no longer have sufficiently current KYC information.

### ***Client’s financial circumstances***

Some commenters expressed concern regarding the proposed language in the Policy Statement which they felt suggested a requirement for advisors to obtain a breakdown of all of a client’s assets and liabilities. Their concern was that the requirement could raise practical concerns as these assets may be held with different institutions, leaving registrants unable to monitor any changes in them.

We have responded by revising the guidance to explain that registrants should take reasonable steps to obtain a breakdown of financial assets. We note that in some cases, a registrant may need to enquire about investments the client holds outside of the registrant to have a better understanding of a client’s financial circumstances, for example, where the client uses leverage or borrows money to invest, or to assess whether an investment might lead a client to become

over-concentrated in a security or sector. See also our response to comments below under the heading *Portfolio approach to suitability*.

We have clarified that it is not our expectation that registrants will monitor investments held outside of the registrant, but we do expect them to make reasonable efforts to keep KYC information current in accordance with the minimum time periods set out in Regulation 31-103. The over-arching principle is that a registrant must always exercise professional judgement to assess whether it has obtained sufficient KYC information in the circumstances, given the client-registrant relationship, to meet its suitability determination obligation.

### ***A client's role in the KYC process and documentation of the process***

Some commenters sought additional guidance on a client's role in the KYC process at the collection, and update stages. Many commenters asked the CSA to clarify how the enhanced KYC process should be documented. For example, the commenters wondered whether a client's signature was required or whether a registrant could document the KYC process in their notes to a client's file.

The Policy Statement provides flexibility in documenting a client's confirmation of the accuracy of information, including any significant changes. Such confirmation may be more formal by obtaining the client's signature (handwritten, electronic or digital) or by alternative methods such as maintaining notes in the client file detailing the client's instructions to change the information. The Policy Statement also suggests implementing additional controls for more sensitive information changes such as in a client's name, address or banking information since these changes may lead to potential fraud.

We have also added guidance stating that registrants should take the opportunity of the initial KYC collection to explain the client's role in keeping KYC information current with the registrant.

### ***Client's investment needs and objectives***

Some commenters expressed concerns with the expectations from the Policy Statement that registrants should set out the investment return that would be required to meet the client's financial goals. Those commenters argued that such requirements would create unrealistic expectations of performance and lead to unintended liabilities for the registered firm and the registered individuals.

Other commenters assert that such requirements are inconsistent with their business model and their registered individuals do not have the necessary training.

Other commenters agreed with the guidance but asked to limit the scope to investments held through the registrant.

The Policy Statement now includes a revised discussion of the ways a registrant may establish a client's investment needs and objectives. The guidance states that depending on the nature of the relationship and the business model, a registrant may find it helpful to set out investment goals

for the client's account or portfolio. This can be done by developing, for instance, an investment policy statement. We set out our expectation that in such cases, a registrant should set out investment goals that are specific and measurable and establish reasonable investment return scenarios for the account, and that the registrant should also provide regular updates to the client on any progress to achieve such investment goals.

### ***Risk Profile***

Some commenters asked for a definition of "risk profile" that includes elements of risk capacity and risk tolerance to be included in Regulation 31-103. Many commenters asked for the CSA to clarify the terms "risk attitude," "risk capacity" and "risk tolerance." Others commented that registrants should be permitted to design their own risk profiles.

We have revised and clarified the guidance concerning determining a client's risk profile.

### ***Keeping KYC information current***

One commenter was of the opinion that all registrants should be required to review KYC information with each client at least annually, while another suggested that reviews be required to be completed at least every two years. Some other commenters were of the opinion that the proposed minimum time intervals are too frequent and rigid. Many commenters did not raise concerns with the proposed prescribed minimum time intervals but asked for more flexibility and clarity on how registrants can manage this update.

Commenters also asked the CSA to confirm that this requirement did not impose an obligation on the registrant to re-collect the KYC information.

Finally, some commenters were of the opinion that reviewing KYC may be of limited value in certain circumstances, such as when the only security in a client's portfolio is an exempt market product with a five-year lock-in period, or for non-individual permitted clients whose KYC information may not change as significantly or frequently.

We do not agree that the prescribed minimum time intervals impose inflexible requirements or are unreasonable. A registrant must make reasonable efforts to keep their client's KYC information sufficiently current to satisfy their suitability determination obligation. Registrants may determine their own time period for reviewing their client's KYC information, but we expect that KYC information to be reviewed at the *minimum frequency* set out in Regulation 31-103.

As noted above, the process for reviewing the client's information does not need to take the form of a face-to-face conversation with the client. The guidance notes that different tools may be used, such as on-line questionnaires, *so long as the process amounts to* a meaningful interaction with the client.

We have also clarified the Policy Statement to explain that we do not expect registrants, in every circumstance, to start over and re-collect all of the client information at every review, or in all circumstances of a potential change.

### *Clarification of the term “reasonably ought to know”*

A few commenters were of the opinion that the requirement to review and update KYC information in certain circumstances and within specific timelines may be inconsistent with the requirement to take “reasonable steps” to keep KYC information current. They questioned the extent of monitoring of a client’s activities that would be required for a registrant to comply with the proposed requirement to review a client’s KYC information when the registrant “reasonably ought to know of a significant change in the client’s KYC information.”

We have responded to this concern by deleting the phrase “reasonably ought to know” in Regulation 31-103 provision. Registrants are now only required to react where they have become aware of a significant change in the client’s information.

We have added new guidance on our expectations as to what constitutes a “significant change” in client information and how registrants could address them, which includes an expectation that they will make reasonable enquiries to determine if any have occurred.

### **3. Comments and responses on the KYP proposals**

We received a large number of comments on this aspect of the CFRs to the effect that the proposed KYP requirement:

- would be too onerous, burdensome, costly and impractical,
- would give rise to unintended consequences, such as the narrowing of product shelves and reduced choice for investors, and
- would not be sufficiently flexible to accommodate different business models or different types of securities with different attributes and risks and would not be workable in a universe where certain firms may make available thousands of different products for clients.

### *Understanding, approving and monitoring securities*

Commenters generally felt that the requirement for firms to understand a security should be scalable depending on the type or complexity of the security and asked for clarity on how the proposed KYP requirements would work in fund of fund contexts, where there is a subadvisor or where model portfolios or proprietary pooled funds are used.

Commenters were particularly concerned about the proposed requirement for a firm to assess how a security that it is considering making available to clients compares to similar securities available in the market, and the majority of the commenters felt that this market comparison requirement was unworkable.

Many commenters felt costs were overemphasized and that the focus on returns was problematic. Commenters also felt that an independent inquiry into securities would not be necessary in all cases and that registrants should be able to rely on regulatory disclosure documents of issuers when doing their due diligence.

Many commenters asked for more flexibility around the approval process for securities.

Finally, we received comments that the requirement to monitor and reassess securities on an ongoing basis, including the competitiveness of those securities, would be costly and burdensome. Some commenters also questioned the value of ongoing monitoring of securities that are illiquid.

### ***KYP requirements for registered individuals***

Many commenters had some confusion over the requirement for registered individuals to generally understand all the securities at the firm available to them to sell or recommend, and thoroughly understand securities they do sell or recommend.

### ***Transfers in and client directed trades***

Commenters were also concerned about the proposed requirements in connection with securities transferred into a firm, as they were considered to be unworkable from a practical perspective and to have the potential unintended consequence of limiting investors' ability to move accounts or forcing the sale of securities. Many commenters questioned the depth of KYP that should be required for securities acquired by a client as a result of a client directed trade that the firm is not otherwise making available to clients.

### ***Exemptions***

Some commenters requested exemptions from certain or all of the KYP requirements. For example, exemptions were requested for portfolio managers in certain circumstances, for firms and registered individuals dealing with permitted clients, and where firms only sell proprietary products or where the securities involved are exempt market or illiquid securities.

### ***Consideration of comments received and clarification of KYP requirements***

As noted in the Proposed Amendments, the proposed amendments to KYP are intended to establish explicit rules concerning KYP and more detailed guidance in the Policy Statement that codify previous CSA and SRO guidance, and also to support an enhanced suitability determination requirement, and increase rigour and transparency around the securities and services that registrants make available to their clients.

After our analysis of comments received, we have made the following changes to Regulation 31-103 requirements:

- removed the registered firm's obligation to assess how a security it is considering making available to clients compares to similar securities available in the market (market comparison requirement);
- narrowed the firm's obligation to monitor and reassess securities, retaining only the requirement to monitor for significant changes to securities a firm makes available to clients;

- removed the obligation to maintain an offering of securities and services that is consistent with how the registered firm holds itself out (in our view, this is unnecessary given the provisions in section 13.18 that a registered firm must not hold itself out in a manner that could reasonably be expected to deceive or mislead a person as to the products or services to be provided by the firm);
- revised the obligations of registered individuals, to clarify that the steps registered individuals must take to understand the securities purchased or sold for, or recommended to, clients are those that are reasonable to enable them to meet their obligations under section 13.3 [*suitability determination*];
- removed the provisions in subsection 13.2.1(6) of the Proposed Amendments in respect of securities transferred in.

We have clarified our expectations in the Policy Statement as follows:

- to provide firms with flexibility in establishing appropriate review, approval and monitoring processes, acknowledging that these processes may vary depending on the business model of the firm, the types of securities offered, the proficiency of the firm's registered individuals, and the nature of the relationships that the firm and its registered individuals have with clients;
- to clarify that the extent of the review, approval and monitoring processes required may vary depending on the structure, features and risks of securities being considered, and that a security by security process will not be required in all circumstances;
- to clarify that we do not expect a duplication of the review, approval and monitoring processes where multiple registrants are involved with securities;
- with respect to the comments on returns of securities, to clarify that registrants must understand the basis of a security's return (we have maintained the emphasis on understanding the initial and ongoing costs of securities and the impact of those costs);
- to clarify that additional due diligence may be necessary where there are reasons to question the validity of an issuer's information or where information provided about securities is not sufficient to permit a meaningful assessment (acknowledging that independent due diligence on securities is not required in all cases);
- to clarify that registered individuals are expected to have, based on their proficiency, a general understanding of the types of securities that are available through the registered firm for them to purchase or sell for or recommend to clients;
- regarding transfers in and client directed trades, to clarify that we expect registrants to take reasonable steps to assess and understand securities transferred into the firm from another registrant, as well as those that are a result of a client directed trade, within a reasonable time after the transfer or trade, and, specifically with respect to registered individuals, we expect that they will have an understanding of all securities held in a

client's account, including those that are held as a result of a transfer in or a client directed trade, in order to make the required periodic suitability determination, acknowledging that the depth of the understanding required may vary depending on the nature of the securities, the client's circumstances and investment objectives, and the relationship between the client and the registrant.

We have considered the requests for exemptions in the context of the revised KYP requirements. We have included an exemption for registered dealers in respect of securities purchased or sold for a client only as directed by a registered adviser acting for the client, and note that the KYP requirements applicable to OEO dealers will be dealt with in IIROC rules. We have not included an exemption for portfolio managers or for situations where a permitted client has waived suitability in the context of the revised KYP requirements. We would still expect firms and their registered individuals to have an understanding of the securities in these situations.

#### **4. Comments and responses on the suitability proposals**

##### ***Putting the client's interest first***

Some commenters felt that the "putting the client's interest first" concept is vague, which will cause uncertainty for registrants in demonstrating compliance. Some commenters suggested that the CSA incorporate a safe harbour that would set out steps a registrant can take to be considered to have met the client first standard. Several commenters suggested that if a registrant meets the specific suitability factors in subsections 13.3(1)(a)(i) to (vii) in the Proposed Amendments, the registrant should be deemed to have satisfied the requirement to put the client's interest first.

We acknowledge the comments. "Putting the client's interest first" is intended to be a broad, principles-based standard. As such, we have not incorporated a safe harbour as proposed by some commenters. However, to add clarity, we have provided some additional detail on this general principle in the Policy Statement. For example, we recognize that

- there is not only one recommendation or decision that will meet this enhanced suitability obligation, but rather there may be several options or courses of action for a registrant to take when recommending securities or services to clients, or when making decisions for clients, that can meet the criteria for a suitability determination,
- depending on the circumstances, including the securities and services offered by the firm and the client's particular circumstances, all of the suitability factors in subsection 13.3(1)(a) of Regulation 31-103 may not be equally applicable to every suitability determination, and registrants are expected to use their professional judgement to determine the weight to put on each of the specific factors subject to the broad standard to put the client's interest first when making their suitability determination,
- when choosing between multiple suitable options, the broad standard means that registrants must put the client's interest before their own interests and any other competing considerations, such as a higher level of remuneration or other incentives, and

- meeting the criteria for a suitability determination, including the requirement to “put the client’s interest first”, does not imply a guarantee of any particular client outcome.

We also explain in the Policy Statement how the client first standard, along with the suitability factors, applies to assessing account type suitability, to periodic reviews of a client’s account, to acting in response to client instructions and liquidating securities, and to the overall approach of assessing suitability for a client.

We believe that the changes we have made to Regulation 31-103 and the Policy Statement provide flexibility and clarity about how to comply with the suitability determination obligation, including the requirement to put the client’s interest first.

### ***Overly prescriptive requirements***

While commenters agreed that a registrant should determine whether an investment action or recommendation is suitable, they felt that the itemized list of factors under subsection 13.3(1)(a) of Regulation 31-103 was overly prescriptive, and may be better situated in the guidance on the basis that

- not all of the factors will necessarily be relevant to every type of investment action or recommendation, and
- making a trade, where not all of the factors can be satisfied, could still be putting the client’s interest first.

The commenters felt that registrants should have the flexibility to determine what criteria are relevant in the circumstances.

In addition, several commenters were of the view that language in the Policy Statement relating to the amount of cash left uninvested in an account was too prescriptive, and that decisions about how much cash to maintain in a client’s account should be made by the registrant and the client, in the context of the specific client’s needs and market conditions.

We acknowledge the comments and have addressed them by removing some of the factors proposed to have been added to subsection 13.3(1)(a) and by adding scalability in the application of the suitability requirements, by recognizing in the Policy Statement that the factors may not be equally applicable to every suitability determination, and that we expect registrants to use their professional judgement to determine the weight to put on each of the factors and, overall, to put the client’s interest first when making a suitability determination. We also provided additional guidance which covers, among other things, specific situations such as suitability requirements when a transfer in occurs.

Finally, we have removed the specific language in the Policy Statement relating to cash held in a client’s account and have clarified that the suitability determination criteria generally apply to decisions about how much cash to leave uninvested in a client’s account, including the obligation to put the client’s interest first when making these decisions.

### ***Cost as a factor in assessing suitability***



We received many comments on cost as a factor to be taken into account in a suitability determination. According to commenters, the Proposed Amendments emphasize cost as the primary consideration for suitability over other factors that may also be important in determining suitability, such that registrants may be incentivized to favour the lowest cost option over any others, which may not necessarily result in the best client outcome.

Conversely, some commenters agreed that cost is one of the most important elements influencing returns, and one commenter recommended that where a higher cost security is recommended, the registrant be required to disclose why the security is suitable and how it puts the client's interest first.

While we agree that the suitability determination should include the consideration of a number of factors, we have maintained the potential and actual impact of costs on the client's returns as an explicit factor to be taken into account when making a suitability determination. We have, however, removed the guidance in the Policy Statement that stated that we expect the lowest cost security that is suitable in the circumstances to be recommended to a client unless the registrant has a reasonable basis for determining that a higher cost security will be better for the client.

We note that the CSA have no default expectations for registrants to automatically select the lowest cost options to meet their suitability determination requirements. However, we expect an assessment of the relative costs of the options available to clients at the firm when making a suitability determination, as well as the impact of those costs. Ultimately, when making a suitability determination, registrants must put the client's interest first, ahead of their own interests and any other competing considerations when selecting between multiple suitable options available to the client, and must document the reasonable basis for their suitability determinations.

### ***Portfolio-approach to suitability***

Many commenters indicated that the factor which suggests a portfolio approach to suitability may not be workable or appropriate in some circumstances. For example, assessing suitability across a client's portfolio would not be workable where a client

- has accounts with discrete investment purposes that are not relevant to the management of the client's other accounts (for example, an account which may be purely for speculative investing, or a cash account held for short-term or emergency needs), or
- is reluctant to share information regarding investments held outside of the registrant (for example, clients may be reluctant to provide additional information for a relatively simple investment transaction).

Commenters also raised the following concerns:

- conducting a suitability analysis that includes securities held or managed outside of the registrant is unsustainable as the registrant will not have continual information about securities held or managed at other firms;
- clients may be misled about the extent to which one registrant's investment strategy will be integrated with those of other registrants;
- information sharing across legal entities or business lines may pose regulatory and system challenges;
- portfolio managers may end up assessing suitability in respect of securities held in an OEO account;
- individual registrants may not have the proficiency to assess suitability of other holdings;
- where multiple managers work for the same client, it is unclear who would be responsible for assessing overall suitability and for making adjustments accordingly;
- the scope of accounts for considering portfolio-level suitability is not clear (for example, is this intended to capture accounts of spouses, families and adult children).

Conversely, a few commenters recommended that registrants be required to make reasonable efforts to understand a client's portfolio of investments not only at the firm, but elsewhere in order to provide recommendations that take into consideration the client's entire portfolio of investments.

We have removed the proposed factor from Regulation 31-103 that required registrants to consider the overall concentration and liquidity across all of the client's accounts at the firm. In addition, with respect to investments held outside of the registrant, we have removed guidance suggesting that a registrant should obtain information about a client's other investments or holdings held elsewhere in order to inform its suitability determination, since we don't expect firms to do a real time suitability analysis on assets held elsewhere. See also our response to comments above under the heading *Client's investment needs and objectives*.

However, it is our view that in order for registrants to meet the criteria in subsection 13.3(1)(b) to put the client's interest's first, suitability cannot be determined only on a trade by trade basis, but must be determined on the basis of the client's overall circumstances, depending upon the relationship between the client and the registrant and the securities and services offered by the registrant. In addition, where a client has multiple investment accounts with a single registrant, we expect that registrant to take into consideration whether a recommendation or decision for one account would materially affect the concentration and liquidity of the client's investments across their other accounts with that registrant. We have added language to the Policy Statement to this effect.

### ***Reasonable range of alternative actions available to the registrant***

Some commenters sought additional guidance regarding the proposed requirement to consider a reasonable range of alternative actions available to the registrant and the language in the guidance that “what constitutes a reasonable range of alternative recommendations or decisions will depend upon the circumstances, including the firm’s product range, the degree of skill and proficiency of the registrant and the client’s particular circumstances.” The commenters were unclear on what the baseline for skill and proficiency were, and whether the alternative considerations would be limited to what the registrant is licensed to sell.

A few commenters felt that the requirement should go further to include a consideration of a reasonable range of alternative actions available through the registered firm or generally available in the marketplace.

We reiterate that registrants have an obligation to consider a reasonable range of alternative recommendations or decisions available to the registered individual through the registered firm when making a suitability determination. We have clarified the language in the Policy Statement to indicate that what constitutes a reasonable range of alternative recommendations or decisions for a client will depend upon the circumstances, including the securities and services offered by the firm to the client, the degree of skill and proficiency of the registered individual and the client’s particular circumstances. What is available to the registered individual through the registered firm is limited to what the individual is licensed to sell, and may be further limited depending on the securities and services offered by the firm to the client. We note that under the RDI requirements, registrants must be transparent about what securities and services they are offering to a particular client, and a client should understand what the registrant can or will offer (and therefore what would be considered as a reasonable range of alternative actions).

### ***Proposed requirement to consider any other factor that is relevant under the circumstances***

Many commenters were concerned that the proposed requirement to consider any other factor that is relevant under the circumstances would be difficult to operationalize and comply with. We have removed this factor from Regulation 31-103.

### ***Triggers for assessing and reassessing suitability***

We received some comments on the triggers for assessing and reassessing suitability.

Some commenters indicated that the requirement to assess suitability “before” a deposit or transfer may cause operational difficulties and investor may be unable to make deposits or transfers with ease or within a reasonable time frame. Some commenters suggested that the assessment should be required to be performed “within a reasonable time”, which would correspond to MFDA guidance, rather than “before” the deposit or transfer.

We have added language to the Policy Statement to recognize that, in some cases, such as when securities are transferred in from another registrant, it may not be possible for registrants to complete the suitability determination required in advance of opening an account for the client. In these types of situations, we expect the registrant to complete the suitability determination

within a reasonable period of time, and have a process in place to restrict investment actions until the suitability determination has been completed.

Commenters also indicated that the requirement to reassess suitability “promptly” after a triggering event in subsection 13.3(2) may not always be practical, and suggested the reassessment should be completed “within a reasonable time”.

The language in Regulation 31-103 and the Policy Statement has been clarified to indicate that the reassessment must be completed “within a reasonable time” in the circumstances. We expect the suitability determination to take place in a timely manner, and the determination of a reasonable time period will depend on the nature of the event itself and the circumstances surrounding the event.

In addition, we have clarified that the triggering events to reassess suitability in subsections 13.3(2)(b) and 13.3(2)(c) occur when a registrant “becomes aware of” the changes referred to in those subsections. We have also provided additional guidance in the Policy Statement on our expectations on the frequency of suitability reassessments when there is a change to a registered individual designated as responsible for a client’s account and on the frequency of account type suitability reassessments.

### ***Client directed trades***

Regarding the proposed changes to the provision on client directed trades, one commenter indicated that it would be overly burdensome, vague and meaningless for a registrant to have to recommend an alternative action. Another commenter was concerned that the guidance appears to narrow the scope of this provision to refer to unsolicited orders and recommended that the guidance be revised to broaden the scope of the provision to include client directed account types.

We do not agree with comments that recommending an alternative action that meets the suitability determination criteria would be overly burdensome or meaningless when a client instruction has been given that would not meet the criteria for a suitability determination. This recommendation would give the client an opportunity to reevaluate the merits of the order or instruction and to have an alternative that would put their interest first when making the investment decision. We have clarified our intention by making only technical changes to the Policy Statement.

## **5. Comments and responses on the conflicts of interest proposals**

### ***Materiality threshold for conflicts***

The majority of the commenters urged the CSA to retain a materiality threshold such that registrants would be responsible for identifying and addressing only material conflicts. The commenters argued that having to identify and address non-material conflicts would impose significant burden on registrants without providing corresponding investor protection or benefits. Also, the commenters mentioned that the materiality assessment should flow through other conflicts requirements including disclosure.

In response to the major concerns raised by the commenters, we have restored the materiality threshold in Regulation 31-103. The proposed amendments to the conflicts of interest rule would require each material conflict of interest identified by the registered individuals or their sponsoring firms to be addressed in the best interest of the client. The proposed amendments to the Policy Statement contain additional guidance on how to identify and respond to material conflicts, including procedures and controls that firms could implement to identify and address such conflicts accurately and in a timely way. Similarly, to avoid unintended outcomes, we retained the existing materiality threshold in the disclosure obligations, which would require registrants to disclose in writing only identified material conflicts of interest to clients whose interests are affected by such conflicts where a reasonable client would expect to be informed of such conflicts.

### ***Best interest standard***

Some commenters indicated that the best interest standard in conflicts is commercially untenable given that some conflicts will not be able to be addressed in a client's best interest, such as for example charging fees for the services the registrant provides. One commenter suggested that the standard of putting the client's interest first be used in the conflict of interest provisions, rather than a best interest standard, as it is more easily understood by registrants.

Many commenters requested guidance on the best interest standard in the conflicts of interest provisions and asked us to confirm whether this standard is intended to impose a fiduciary duty on all registrants. As noted above, the CFRs do not impose a fiduciary duty on the conduct of registrants toward clients. The requirement to address material conflicts of interest in the best interest of a client is a regulatory standard implying that, amongst other things, when addressing the conflict, registrants must put the interests of their clients first, ahead of their own interest and any other competing considerations.

We indicate in the Policy Statement that registrants must address conflicts of interest by either avoiding those conflicts or by using controls to mitigate those conflicts sufficiently so that the conflict has been addressed in the client's best interest. We provide guidance on the controls that registrants could consider, including implementation and maintenance of policies and procedures providing for example, a broad definition of what constitutes a material conflict of interest, as well as an escalation procedure on how to handle potential conflict situations.

We note that the firm should establish, as part of its compliance system, appropriate measures of remediation of non-compliance, robust compliance training and periodic review and testing with respect to the conflicts of interest requirements.

### ***Addressing conflicts***

Some commenters asked us to provide greater clarity about what it means to address a conflict in the best interest of clients. Several commenters expressed the view that registrants should be required to do more than address conflicts and asked that Regulation 31-103 be revised to require registrants to "actively mitigate" conflicts of interest or "disclose and mitigate conflicts of interest in the client's favour."

Regarding the requirement that a registered firm must avoid any conflict of interest that is not, or cannot be, addressed in the best interest of the client, one commenter urged the CSA to indicate whether avoidance is the only option, and urged the CSA to indicate whether it is acceptable, for example, to proceed where a client acknowledges and consents to the use of proprietary products. Two commenters suggested that the requirement be revised such that a registered firm must decline to provide the service associated with the conflict that is not, or cannot be, addressed in the best interests of the client.

We have not modified Regulation 31-103 to replace the term “address” with “actively mitigate” conflicts of interest or “disclose and mitigate conflicts of interest in the client’s favour”. In our view, those phrases would not capture several possible actions a registrant could consider taking in order to eliminate the effect of a conflict of interest. We believe the term “address” better encompasses a wide range of actions a firm could reasonably take, including implementing appropriate controls to sufficiently mitigate the effect of the conflict, or avoiding the conflict altogether.

### ***Reasonably foreseeable conflicts***

Some commenters asked for further clarity on what “reasonably foreseeable” means and how firms will be held accountable for having met the test at the time. Some commenters were concerned about the forward-looking nature of the term and were of the view that it makes Regulation 31-103 overly broad, could be subject to hindsight application, and does not strike the right balance between investor protection and fair and efficient capital markets.

We believe the reinstatement of the materiality threshold, together with the guidance on when a conflict of interest is material, will constitute an appropriate foundation to determine the minimum requirement with respect to the level of conflict of interest that a registered firm and its registered individuals must identify, disclose and address in the best interest of the client.

### ***Sufficiency of disclosure***

Many commenters expressed the view that disclosure alone can be sufficient in some circumstances and that Regulation 31-103 should accommodate this by allowing registrants to use their professional judgement about when disclosure alone is sufficient. Conversely, other commenters argued that excessive reliance on disclosure to help mitigate conflicts would not meet the principles of the best interest standard.

Some commenters asked the CSA to create a standardized conflict disclosure document, or at minimum, to provide additional guidance on the form that conflicts disclosure should take and the level of detail that should be presented.

We recognize that the effectiveness of disclosure as a tool for addressing material conflicts of interest may depend upon the level of sophistication of the clients and the extent to which they are able to understand and act upon the information given to them. However, to address a conflict of interest in the best interest of clients, we believe disclosure in conjunction with other controls (including pre-trade controls and/or post-trade reviews) must be used. In addition, not only does disclosure sometimes fail to mitigate the risks related to conflicts of interests, but in some cases, disclosure of conflicts may aggravate the potential risks to the client’s interest.

We believe it is up to the firm to design its own conflicts disclosure document, in accordance with the obligations provided in Regulation 31-103. The use of a conflict of interest disclosure document will depend on the facts and circumstances of a given situation. As such, we did not prescribe a specific form of the disclosure document as registrants are too varied in their business model. A firm's compliance policies and procedures should be reasonably designed to address and be proportionate to the various circumstances surrounding the conflict of interest situation. While the registrant should take into consideration the specific information to be included in the disclosure prescribed under subsection 13.4.1(5) of Regulation 31-103, we believe the professional judgement of the registrants should guide their conduct to ensure they comply with the disclosure requirements in a timely manner.

### ***Conflicts that must be avoided***

Regarding the general prohibition in the Proposed Amendments against borrowing from and lending to clients as well as the general prohibition against acting as a power of attorney or trustee for clients, some commenters raised the concern that there are common and unobjectionable industry practices that would be inadvertently prohibited by Regulation 31-103.

Two commenters advocated for a complete ban against borrowing, lending, powers of attorney and trusteeships. Those commenters also proposed a ban on referral fees from lenders to registrants who have referred clients to the lender for the purposes of borrowing money to engage in leveraged investing.

In response, the CSA have removed section 13.4.4 of the Proposed Amendments relating to conflicts of interest that must be avoided, and amended section 13.12, specifying exceptions regarding obligations relating to restriction on borrowing from, or lending to clients. We also removed from Regulation 31-103 the requirements relating to prohibitions on acting as a power of attorney or trustee for clients. However, we are of the view that a registrant having full control or authority over the financial affairs of a client may create a material conflict of interest and we expect registered firms to have policies and procedures in place to ensure that these conflicts are identified and are either avoided or otherwise addressed in the client's best interest.

### ***Representatives obtaining consent from firms to act notwithstanding conflicts***

Some commenters expressed concern that the obligation of a registered individual to get their sponsoring firm's permission to proceed with a conflicted activity could create significant inefficiencies. If, however, firms are allowed to provide "standing approvals" for conflicts that the firm has addressed, for example pursuant to the firm's policies and procedures, then this could help address that concern. One commenter requested additional guidance on when a registered representative should avoid a conflict when their sponsoring firm has consented to it.

We have clarified in the Policy Statement that a firm can provide consent in a number of ways. For example, if a registered individual's activity is conducted in accordance with their sponsoring firm's policies and procedures related to that conflict, this may be sufficient.

As provided in the Policy Statement, a registered individual must also assess whether proceeding with the activity in question is in a particular client's best interest. If the registered individual

concludes that proceeding would not be in the client's best interest, the registered individual must not engage in that activity.

### ***Timing of disclosure***

Some commenters asked that a conflict that is disclosed at the time of account opening not be required to be disclosed again when the conflict arises in a specific transaction; alternatively, the commenters asked that such conflict be permitted to be disclosed orally.

We note that although subsection 13.4(7) does not require registered firms to remind clients of conflicts disclosure that has already been provided to them, registrants should take into consideration their obligation to deal fairly, honestly and in good faith with clients in the case of a transaction that presents a conflict which was disclosed a long time ago. However, in response to comments, we have clarified in the Policy Statement that there is no requirement that such reminders must always be provided to the client in writing.

### ***Recommending a security that the registrant owns***

Several commenters indicated that recommending a security that they own is not necessarily a conflict that must be disclosed. We recognize that there may be circumstances where recommending a security that a registrant owns does not necessarily present a material conflict of interest. We revised the Policy Statement to indicate that if a registered individual recommends a security that they own, this "may", rather than "will" constitute a material conflict which should be disclosed to the client before or at the time of the recommendation.

### ***Third-party compensation (embedded commissions)***

Many commenters expressed the view that the CSA has taken too hard of a position in the guidance on third-party compensation conflicts. The commenters stated that treating such compensation as a *de facto* conflict, coupled with the onerous controls described in the guidance, will amount to an indirect ban on third-party compensation and embedded commissions. Some commenters suggested that the CSA revise the applicable provisions of Regulation 81-105 to sales practice rules, including the application of those rules to products beyond mutual funds in order to ensure a level playing field.

After our analysis of these comments, we remain of the view that it is a material conflict of interest for a registrant to receive third-party compensation. A registrant may offer a security with embedded commissions to a client if it is able to demonstrate that the recommendation is based on the quality of the security without influence from any third-party compensation associated with the security.

The Policy Statement provides examples of controls a registrant can consider implementing to address the conflict in the best interest of their clients. As noted above, the CSA are currently working on a policy response intended to address the primary investor protection issues arising from embedded commissions.



### ***Fee-based accounts***

A few commenters stated that registrants with fee-based accounts should not be required to “make a client whole” if the registrant does not benefit from the commission-paying security held in the fee-based account.

One commenter asked the CSA to give clear guidance on instances in which a fee-based account is not suitable for a client, for example in circumstances where clients are charged more when moved to a fee-based account than when they were being charged through an embedded fee. Another commenter expressed that the guidance should be interpreted to accommodate products with third party compensation where they may be better for a client than a fee-based compensation arrangement.

We have revised the guidance to remove references to making a client whole. However, we maintain that placing a client in a fee-based account that holds securities with embedded commissions may be considered to be a material conflict of interest that must be addressed in the best interest of the client.

### ***Internal compensation and incentive conflicts***

We received several comments on this aspect of the Proposed Amendments:

- some commenters disagreed with the proposed guidance on how to address internal compensation and incentive conflicts. On the one hand, the commenters stated that it is not the CSA’s place or role to regulate how registered firms manage the performance of their registered individuals;
- on the other hand, a few commenters stated that compensation structures that misalign the interests of registrants with their clients should be prohibited;
- one commenter suggested that remuneration from an action generally should be prohibited while a conflict of interest relating to that action remains unresolved;
- some commenters asked the CSA to provide more guidance regarding the controls that firms should consider when addressing various conflicts, including supervisory conflicts and compensation and incentive conflicts;
- a few commenters recommended that the guidance on supervisory conflicts be expanded to include non-monetary compensation conflicts at the supervisory level, beyond sales and revenue generation;
- regarding the required disclosure of “any commissions or other compensation that they will be receiving in respect of the transaction,” one commenter sought clarification and asked that disclosure only be required for compensation that gives rise to a conflict of interest;

- one commenter requested additional guidance on how a registered representative could demonstrate having acted in a client's best interest when they are paid a higher commission relative to a similar product.

We have revised our expectation on conflict management relating to internal compensation and incentives. We remain however of the view that there is an inherent conflict of interest for registered firms to create incentives to sell or recommend certain products or services over others, or for registered individuals, to receive greater compensation from their sponsoring firm for the sale or recommendation of certain products or services over others.

We expect registered firms to address this conflict in the best interest of clients by implementing policies and procedures sufficient to mitigate the risk to clients' interests and to closely monitor for compliance with these policies and procedures. If a registrant cannot address these conflicts in the best interest of its clients, the registrant must avoid them. We have provided in the Policy Statement examples of controls to take into consideration when considering how to address such conflicts in the best interest of their clients, which includes maintaining internal compensation arrangements that do not differ by product or service sold to the client, or by account or client type.

### ***Proprietary products***

We also received several comments on this aspect of the Proposed Amendments:

- many commenters asked for more guidance regarding the controls and disclosure that would be sufficient to meet the best interest standard when offering proprietary products;
- on the other hand, many commenters were of the view that the CSA proposals were far too granular and urged the CSA to defer to the registrants to develop their own practices and conflicts mitigation strategies;
- some commenters sought express recognition that selling only proprietary products is a valid business model and is not a conflict of interest as long as the firm ensures that there is a wide range of proprietary products suitable for the financial needs and objectives of the vast majority of the clients and discloses to the clients that the recommendations they will receive are only for proprietary funds;
- one commenter recommended that the reforms clarify that offering proprietary products on a product shelf or recommending a proprietary product is not subject to a higher compliance standard than non-proprietary products;
- some commenters asked that the CSA clarify that we do not consider certain pooled funds to be proprietary products or asked that they be explicitly carved out from the guidance related to proprietary products;
- one commenter was concerned that the provisions seem to suggest that, for proprietary products, there is a concentration level that must be observed. In their opinion, the same concerns relating to product concentration apply to third party products as well and

consequently, the proposed monitoring and disclosure should apply to all products recommended to the clients;

- some commenters encouraged the CSA to revise the guidance addressing non-monetary conflicts relating to proprietary products to clarify that setting targets or quotas for the sale of proprietary products is inappropriate for firms providing both proprietary and non-proprietary products;
- one commenter advocated banning the sale of proprietary products by affiliated dealers, given the inherent conflicts;
- one commenter asked that the guidance or Regulation state that proprietary products should be transferable outside of the related dealer;
- one commenter advocated that guidance for proprietary only firms with respect to the comparison with non-proprietary products should only apply when dealing with retail clients.

The CSA carefully reviewed the comments received regarding proprietary products. We are still of the view that there is an inherent conflict of interest for a registered firm to trade in, or recommend, proprietary products to clients. As such, firms that do so must be able to demonstrate that they are addressing this conflict in the best interest of the clients.

We have included guidance in the Policy Statement on how registrants can generally address conflicts raised by the sale of proprietary products, and how firms with different business models could comply with the requirement under the proposed requirements. We maintain that the guidance in the Policy Statement provides sufficient direction to registrants and addresses the comments received, without being overly prescriptive.

## **6. Comments and responses on the referral arrangement proposals**

We received many comments concerning the proposed changes to the provisions on referral arrangements, as well as the questions we asked in the Notice of publication for comments: “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?”

While some commenters were supportive of the Proposed Amendments, many commenters were of the opinion that the CSA did not adequately consult with the investing public or with the industry to understand the value of referral arrangements for investors, or to understand the potential magnitude of impact and unintended consequences of the Proposed Amendments. Many commenters strongly advocated for the CSA to move these amendments into a separate workstream to allow for further collection of data and consultation.

The CSA has decided not to move forward with the Proposed Amendments in respect of referral arrangements at this time, although some drafting changes have been made to the referral provisions.

We note, however, that guidance has been added to the Policy Statement (in Part 11 and Part 13) to reflect our view that paid referral arrangements create material conflicts of interest that must be addressed in the best interest of clients, and to provide additional clarity with respect to our expectations on

- a registrant’s obligation to address the conflict in the best interest of clients and make appropriate disclosure to clients,
- recordkeeping, monitoring and supervision related to referral arrangements, and
- actions to be taken by a registrant making a referral to satisfy itself that the other party to the referral arrangement is appropriately qualified to perform the contemplated services, and if applicable, is appropriately registered.

## **7. Comments and responses on the RDI proposals**

### ***Publicly available information***

We received many comments concerning the proposed requirement to make publicly available information that a reasonable investor would consider important in deciding whether to become a client of the registered firm.

There was confusion among some of the commenters about the generic nature of the information. Several industry commenters pointed out that many firms offer tailored services to clients, which they argued cannot be covered in generic public disclosure. A related argument was that charges are individually negotiated, so it would not be practical to include them. Another related argument was that some of the information firms would be required to disclose to the public, particularly how much they charge clients, should be treated as proprietary secrets. There were also comments that revealed some confusion about the flexible delivery options that we intended. Two commenters suggested delivering this comparison-shopping information at the point of sale.

Two commenters said that this requirement may require firms to maintain two separate websites – one for the United States and one for Canada – to avoid offending Securities and Exchange Commission rules with respect to discussing funds without triggering the general solicitation prohibition. One commenter expressed the view that firms should not have the option to deliver the information by email or in paper form in lieu of making the information available on its website. Another commenter indicated that the content should be dependent on the delivery channel.

We have decided not to include the proposed publicly available information requirements in the Amendments.

### ***Too much RDI***

Several commenters were concerned that firms are already required to give clients so much disclosure that the proposed additions to the RDI requirement could have the counter-productive

effect of discouraging clients from reading the RDI documents received from their registrants. Commenters suggested that the CSA develop a refined RDI requirement, utilizing modern methods to test its effectiveness with investors.

We are conscious of the issues related to making disclosure effective, however a comprehensive review of the kind suggested was not within the scope of this project. We note that behavioral insights research indicates that how information is presented can be an important factor, and we encourage registrants to review the formatting and presentation of their RDI materials with this in mind. We have taken care to include only a necessary minimum of new information in the RDI component of the Amendments.

### ***Too much emphasis on costs***

A particular focus of many comments was the proposed requirement to explain the impact of charges and fees on a client's investment returns. The general tenor of industry comments was that the Proposed Amendments as a whole placed too much emphasis on costs. Some commenters, primarily investor advocates, took the opposite view, one providing a detailed suggestion for an expanded prescriptive requirement.

We have kept the requirement in the Amendments (with minor drafting changes), since there can be no meaningful assessment of the value of advice and trading services without an understanding of their costs, which research has shown many investors lack. And, we do not think it is possible to explain the impact of costs without including consideration of the effect of compounding over time. To ensure there is no misunderstanding on this point, we have made it an express part of the requirement. We did not adopt the suggestion for expanded disclosure of the impact of investing costs because we felt that a principles-based requirement would be more scalable to different firms' operations, and because we were mindful of the need to minimize additions to the RDI requirements. We accepted a comment that it would be more realistic to require a *general* explanation. Consistent with the proposed guidance, we also changed the requirement to refer to "*potential* impacts".

One commenter thought that the mandated reports on charges and on investment performance already address these concerns. We disagree since those reports are provided annually after the client-registrant relationship has been established, and there is no requirement that they include in them a discussion of impacts.

### ***Restricted offerings and proprietary products***

We also received several comments recommending changes to the proposed requirements for disclosures relating to proprietary products, which were

- to expand the general description of products and services to include any restrictions, including whether a registered firm will primarily or exclusively provide proprietary products to a client, and
- for an explanation of the impact on the client's investment returns from any such restrictions.

Some industry commenters were concerned that there seemed to be an underlying assumption that the use of proprietary products will negatively affect a client's after-cost investment returns. There was also a concern that these requirements may not be relevant to the client-registrant relationship where a firm's entire operating model is based on very restricted offerings, as is often the case for exempt market dealers in particular.

We continue to believe that there is an inherent conflict of interest when proprietary products are recommended to, or chosen for, a client and have therefore maintained a requirement to disclose the use of proprietary products. However, we understand the concern expressed that it should not be assumed that their use will necessarily have an impact (negative or otherwise) on clients' returns. We also recognize the concern that discussing the impact of restricted offerings may be of limited value in some circumstances. The Amendments do not include the proposed requirement to discuss the impact of restricted offerings, including proprietary products. Issues related to restricted product offerings are discussed in the Policy Statement guidance on RDI under the heading *Description of products and services*. How registrants can address the conflicts of interest associated with proprietary products (and potentially related compensation practices) is discussed in the guidance on conflicts of interest.

### ***Other comments***

We received single comments on some other matters relating to the RDI component of the Proposed Amendments. Some we felt were in fact already addressed in Regulation 31-103 or the Policy Statement.

One commenter asked whether a registrant restricted in what it can offer clients because of terms and conditions imposed in response to compliance deficiencies would be required to explain to clients that that is the reason for the restricted offering. There is no express requirement to explain the reasons for a limited offering, but a firm should consider how the standard of care would apply in such circumstances and, in any event, terms and conditions may specifically address the issue.

## **8. Comments and responses on other proposals**

### ***Firm's Obligation to provide training***

Many commenters requested additional guidance in respect of the requirement for a firm to provide compliance training. Many commenters expressed concerns about the know your product component of a firm's training program. Some commenters also suggested that small firms should have more flexibility in designing and implementing a training program. A few commenters suggested that registered advising representatives and associated advising representatives, as well as SRO members should be exempted from the training requirements.

We have revised the guidance in the Policy Statement to provide firms with more flexibility in how they implement, maintain and document their compliance training program. We also recognize that the scope of a firm's compliance training program will depend on the nature, size and complexity of its business. We have clarified the language in the Policy Statement.

We do not propose to exempt registered advising representatives and associated advising representatives, or SRO members from the training requirement but have clarified the Policy Statement language to recognize that as part of its KYP obligation, a firm should assess whether any additional training or proficiency requirements are necessary in order for its registered individuals to understand the securities and make appropriate suitability determinations.

### ***Misleading Communications***

Many commenters expressed support for the proposed prohibition in s. 13.18 and agreed that registered representatives should not use titles or designations that can create confusion and that are misleading for clients. Some commenters suggested that the scope of the proposed prohibition should be expanded to apply to all of a registrant's communications with the public, rather than focusing on the use of titles or designations. Some industry commenters suggested that the scope of the proposed prohibition is too broad and argued that the prohibition is not necessary for registrants who are not in a client-facing relationship.

A few industry commenters:

- noted that it is common in the industry for individuals to hold titles such as “Vice President” to indicate seniority, without being appointed a corporate officer of the registered firm and expressed concerns with the proposed change that would prohibit a registered individual from using a corporate officer title unless their sponsoring firm has appointed that registered individual to that corporate office pursuant to applicable law;
- asked that registered individuals be permitted to use a designation (such as “President’s Club”) which is based on a sales or revenue based recognition in certain circumstances (e.g., on their LinkedIn profile);
- disagreed with the characterization of “independence” in the proposed guidance.

We acknowledge these comments but we continue to believe that the proposed prohibition, including the provisions about the use of corporate titles, as well as titles, designations, awards or recognitions based on sales activity or revenue generation, is a step in the right direction to address the concerns relating to the misplaced reliance on or trust of clients in their registrants. We have revised Regulation 31-103 to clarify that the proposed prohibition applies to registrants in a client-facing relationship.

### ***Record keeping requirements***

We have clarified the Policy Statement language in respect of the record keeping requirements to conform with the changes we have made to the proposed KYC, KYP, suitability and conflicts of interest requirements.

Two commenters asked us to exempt other compensation arrangements and incentive practices from which the firm or its registered individuals, or any affiliate or associate of that firm, benefit from the proposed record keeping requirement set out in paragraph 11.5(2)(q)(ii). We have considered the request for this exemption but we remain of the view that these are relevant to a

firm's obligation to identify conflicts of interest and to address material conflicts of interest in the best interest of the client, and accordingly, we have not amended this record keeping requirement.



## ANNEX C

### LIST OF COMMENTERS

1. Advocis
2. AGF Investments Inc.
3. Alternative Investment Management Association (AIMA)
4. Anita Anand (University of Toronto)
5. Antares Investment Management, Inc.
6. Art Ross
7. Assante Wealth Management Ltd.
8. Association of Canadian Compliance Professionals (ACCP)
9. Aviso Wealth Inc.
10. BCV Asset Management Inc.
11. Belay Wealth Inc.
12. Bentley Beck
13. BlackRock Asset Management Canada Limited
14. BMO Financial Group
15. Borden Ladner Gervais LLP
16. Brent Wolverton
17. Bruce Foster (Foster Agency)
18. Canadian Association of Independent Life Brokerage Agencies
19. Canadian Bankers Association
20. Canadian Foundation for Advancement of Investor Rights (FAIR)
21. Canadian Imperial Bank of Commerce
22. Canadian Independent Asset Management
23. Capital International Asset Management
24. Cardinal Capital Management, Inc.
25. CARP
26. Chad Viminitz
27. Chester R. Brothers
28. Children's Education Funds Inc.
29. CI Investments

30. Coalition des associations de consommateurs du Québec (CACQ)
31. Conseil des fonds d'investissement du Québec (CFIQ)
32. C.S.T. Consultants Inc.
33. Cumberland Private Wealth Management Ltd.
34. D. and S. Reid
35. Dale Butler (Butler Financial)
36. David C.C. Lister
37. David W. Martin
38. Derek Moran
39. Desjardins
40. Dixon Mitchell Investment Counsel Inc.
41. Doherty & Associates Ltd.
42. Donald I. Campbell (Canadian Compliance & Regulatory Law)
43. Edward Jones
44. Farm Business Consultants and FBC Financial & Estate Planning Services Inc. (Ken Roussele)
45. Federation of Mutual Fund Dealers
46. Fidelity Investments Canada ULC
47. Franklin Templeton Investments Corp.
48. Goldstein Financial Investments Inc.
49. Groupe Cloutier Investissements
50. Guardian Capital Group Limited
51. Highstreet Asset Management Inc.
52. HUB Capital Inc.
53. Huxton Black
54. iA Financial Group
55. ICI Global
56. Independent Accountants' Investment Counsel Inc. (IAIC)
57. Independent Financial Brokers of Canada (IFB)
58. Institute of Advanced Financial Planners
59. Integral Wealth Securities Limited
60. Invesco Canada Ltd.
61. Investment Industry Association of Canada (IIAC)

62. Investment Planning Counsel Inc.
63. Investor Advisory Panel (IAP)
64. Investors Group Inc.
65. IRONSHIED Financial Planning Inc. & CANi Financial Planning Syndicate Inc.
66. Jacquie Skinner (Premier Financial Planning Services Inc.)
67. James Doer
68. Jamie Graham (Insight Wealth and PEAK Investment Services Inc.)
69. Jamie Robb (Fiducia Wealth Management)
70. Jason M. Pereira
71. Jeff Schreiter
72. John Davis (Blackburn Davis Financial Inc.)
73. Keith Muchan
74. Kelley Doerksen
75. Kendall and Deborah Bingeman
76. Kenmar Associates
77. Kevin Brugger (Brugger Wealth Management)
78. Kinsted Wealth Inc.
79. Knowledge First Financial
80. Leede Jones Gable Inc.
81. Link Plan Management Inc.
82. LOGiQ Asset Management Ltd.
83. Logan Wealth Management
84. M3 Securities
85. Mackenzie Financial Corporation
86. MacNicol & Associates Asset Management Inc.
87. Manulife
88. Matt Churchill
89. McDougall Gauley LLP
90. Merici Services Financiers Inc.
91. MICA Capital Inc.
92. Michael G. Sheffar
93. National Bank of Canada

94. National Society of Compliance Professionals (NSCP)
95. Nest Wealth Asset Management Inc.
96. Nicola Wealth Management
97. Osler, Hoskin & Harcourt LLP
98. Pacific Spirit Investment Management Inc.
99. PEAK Financial Group
100. Portag3 Ventures
101. Portfolio Management Association of Canada (PMAC)
102. Portfolio Strategies Corporation
103. Primerica
104. Private Capital Markets Association of Canada (PCMA)
105. Provisus Wealth Management
106. Questrade, Inc.
107. RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc., RBC Global Asset Management Inc., RBC Phillips, Hager & North Investment Counsel Inc., RBC InvestEase Inc. and Phillips, Hager & North Investment Funds Ltd.
108. RESP Dealers Association of Canada and Children's Education Funds Inc.
109. Responsible Investment Association
110. Scotia Capital Inc. and Scotia Securities Inc.
111. Stephen V. MacDonald (Blackburn Davis Financial)
112. Sterling Mutuals Inc.
113. Stikeman Elliott LLP (Alix d'Anglejan-Chatillon, Jeffrey Elliott, Nicholas Badeen, Ramandeep K. Grewal)
114. Stikeman Elliott LLP (Edward J. Waitzer, Darin R. Renton, John C.P. Henderson)
115. Sun Life Financial
116. Susanne Hopfner and Donna Wildeboer (Wealth Advance Investments)
117. Tacita Capital Inc.
118. TD Wealth
119. TenSquared Investments Inc.
120. The Canadian Securities Institute (CSI)
121. The Canadian Advocacy Council for Canadian CFA Institute Societies
122. The Investment Funds Institute of Canada (IFIC)
123. Tim Faught

124. Timothy B. Potter
125. Todd Johnson
126. TPC Financial Group Ltd.
127. Tradex Management Inc.
128. Tri View Capital Ltd.
129. Universitas Management Inc.
130. Veronica Armstrong Law Corporation
131. WealthBar Financial Services Inc.
132. Wealhsimple Inc.
133. W.J. Templeman
134. William J. Henderson
135. Worldsource Wealth Management Inc.

## ANNEX D

### ADOPTION OF THE AMENDMENTS

The Amendments to Regulation 31-103 will be implemented as:

- a rule in each of Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island and Yukon
- a regulation in Québec
- a commission regulation in Saskatchewan

The Amendments to the Policy Statement will be adopted as a policy in each of the CSA member jurisdictions.

In Ontario, the Amendments to Regulation 31-103, as well as other required materials, were delivered to the Minister of Finance on October 3, 2019. The Minister may approve or reject these Amendments or return them for further consideration. If the Minister approves the Amendments or does not take any further action, the Amendments will come into force on December 31, 2019.

In Québec, the Amendments to Regulation 31-103 are adopted as a regulation made under section 331.1 of the *Securities Act* (Québec) and must be approved, with or without amendment, by the Minister of Finance. The regulations will come into force on the date of its publication in the *Gazette officielle du Québec* or on any later date specified in the regulations. It is also published in the Bulletin of the Autorité des marchés financiers.

In British Columbia, the implementation of the Amendments to Regulation 31-103 is subject to ministerial approval. If all necessary approvals are obtained, British Columbia expects these Amendments to come into force on December 31, 2019.

In Saskatchewan, the implementation of the Amendments to Regulation 31-103 is subject to ministerial approval. If all necessary approvals are obtained, these Amendments will come into force on December 31, 2019 or if after December 31, 2019, on the day on which they are filed with the Registrar of Regulations.