ANNEX D

SUMMARY OF COMMENTS ON CONSULTATION PAPER 33-404 AND RESPONSES

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

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

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

1. Comments and responses on the conflicts of interest proposals

General

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

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

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

Effectiveness of the current rules governing conflicts of interest

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

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

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

Prioritizing the client’s interest

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

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

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

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

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

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

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

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

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

2. Comments and responses on the KYC proposals

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

Level of proficiency on tax related matters
Several commenters believe that collecting tax information when the representatives do not have any tax expertise does not serve the interest of investors, creating risks of reliance and a potential for errors which could harm clients. Because the required industry courses only provide a basic outline, registrants should not be encouraged through regulation to give advice on tax strategies. This could result in investors not seeking independent tax advice and could cause investors to believe that they are receiving tax or financial planning advice when this is not the scope of the agreed upon professional relationship.
Furthermore, many commenters believe that clients may perceive requests for this information as an intrusion in their affairs, and not all clients may be willing to provide this information. Finally, requiring the collection of tax information may increase significantly the costs of professional liability insurance and consequently, the service fees paid by clients.

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

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

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

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

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

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

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

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

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

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

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

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

- key elements to be considered by the registrant with respect to the collection of KYC information,

- client's authorization for the KYC information collected both at initial account opening and upon material changes, and
- frequency with which the KYC information should be updated.

3. Comments and responses on the KYP proposals

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

The CSA considered the comments received on the KYP proposals for both registered firms and representatives and, in particular, considered the likelihood of the unintended consequences of the KYP proposals raised by commenters if the reforms were to be implemented as proposed in CP 33-404. The CSA have significantly redesigned the proposals.

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

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

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

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

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

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

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

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

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

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

4. Comments and responses on the suitability proposals

General

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

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

Finally, many commenters do not believe it is necessary for a significant market event to trigger a new and full suitability analysis in all instances where the client is exposed as it may not lead to a different outcome. According to several commenters, it is unlikely that a market event, even if significant, will have changed the nature of the risk profile of a particular security or the client's portfolio. Likewise, the commenters observed that a material change in the risk profile of a single issuer should not, in a portfolio that is suitable, be cause for an immediate suitability analysis in all instances.

Financial strategies as part of the suitability determination process

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

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

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

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

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

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

CSA Response
We agree with comments that the use of the phrase "most likely" and referring to "client's investment objectives" could establish unrealistic client expectations of guaranteed outcomes. Instead, the CSA propose that there must be "a reasonable basis" to conclude that an investment action taken by a registrant satisfies prescribed criteria for a suitability determination. That determination would not only require that an investment action taken by a registrant be suitable based on prescribed factors, but also that it puts the client's interest first.

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

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

5. Comments and responses on the RDI proposals

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

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

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

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

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

- some firms that would be categorized as mixed/non-proprietary may offer a much broader range of products than others,
- what a given firm offers some types of client may differ from what it offers others,

- proportions of proprietary and non-proprietary products may change frequently, and
- there may be a perceived implication that one type of product is inherently better.

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

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

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

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