CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Request For Comment

Proposed Amendments to

National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

and to

Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

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

June 21, 2018

Introduction

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

This notice contains the following annexes:

- Annex A – Proposed Amendments to NI 31-103
- Annex B – Blackline showing changes to NI 31-103 under the Proposed Amendments
- Annex C – Blackline showing changes to 31-103CP under the Proposed Amendments

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

- Annex E – Local matters

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

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

Substance and purpose

Introduction – Client Focused Reforms
The Proposed Amendments are part of the CSA's harmonized response to concerns we have identified relating to the client-registrant relationship as it stands today. After extensive consultations with stakeholders, we are proposing changes that we believe will achieve our stated goals of better aligning the interests of registrants with the interests of their clients, improving outcomes for clients, and making clearer to clients the nature and the terms of their relationships with registrants.

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

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

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

In preparing the Proposed Amendments, we have taken comments from the consultations into consideration. We have sought to make the Proposed Amendments scalable to fit registrants' different operating models, and to preserve the technology-neutral stance of the Instrument.

Additional harmonized reforms that the CSA intends to develop at a later stage are discussed below.

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

Overarching regulatory best interest standard

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

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

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

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

Overview and scope of the Proposed Amendments

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

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

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

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

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

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

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

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

Other CSA consultations

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

Background

Consultation Process

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

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

After publishing a status report[1] which indicated the key themes that emerged from the public comments on CP 33-403, we followed up with CP 33-404, published on April 28, 2016. CP 33-404 set out our key concerns with respect to the client-registrant relationship and invited comment on a number of potential reforms to address those concerns. CP 33-404 sought comment on proposed targeted reforms aimed at enhancing the obligations of registrants towards their clients, and a proposed overarching best interest standard that would serve as the principle that would govern the interpretation of all other client-related obligations. Both consultation papers were followed by in-person consultations in a variety of forums, as well as the publication of research on conflicts of interest relating to registrants' compensation arrangements and incentive practices.[2]

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

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

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

Response to Consultations

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

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

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

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

Key Concerns

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

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

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

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

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

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

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

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

Summary of Proposed Amendments

Introduction

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

Some of the Proposed Amendments would impose new requirements, while others would codify best practices set out in existing CSA and SRO guidance. The combination of the codification of

best practices and the introduction of new requirements will result in a new, higher standard of conduct for all registrants.

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

KYC – section 13.2 [Know your client]
The Proposed Amendments to the KYC requirements are our response to a primary area of concern in the industry and provide clarity on our expectations of what information a registrant must collect to 'know a client' and how frequently this information must be updated. These enhanced KYC requirements are intended to support the enhanced suitability determination requirement, which we propose to amend by requiring that registrants put the client's interest first when determining suitability. This new requirement cannot be met without having complete and specific KYC information.

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

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

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

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

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

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

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

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

We propose significantly expanded guidance in 31-103CP with respect to our expectations for these requirements. This includes, among other things, discussions of

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

KYP – new section 13.2.1 [Know your product]

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

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

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

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

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

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

- 13.2.1(3) – obligations of registered individuals to take reasonable steps to
    - understand at a general level, the securities that are available for them to purchase, sell or recommend through their firm, and how those securities compare
    - thoroughly understand each specific security they purchase, sell or recommend to a client, including the impact of all of the costs associated with acquiring and holding the security

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

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

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

We propose guidance in 31-103CP with respect to our expectations as to how registrants may meet their KYP obligations. The guidance is detailed and pays particular attention to setting out our views concerning the process of approving a security, product costs, compensation structures and the use of proprietary products, and the importance of taking related conflicts of interest into account.

Suitability – section 13.3 [Suitability determination]

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

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

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

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

- 13.3(1) – current suitability requirement replaced with new subsection providing that before a registrant acts by opening an account for a client, purchasing, selling, depositing, exchanging or transferring securities for a client's account, taking any other investment action for a client or making a recommendation or decision to take any such action, the registrant must determine, on a reasonable basis, that the action
    - is suitable for the client, based on certain factors, including
        - KYC information
        - the registrant's understanding of the security
        - the features and associated costs of the account type
        - the impact on the account
        - portfolio-level concentration and liquidity
        - the analysis of the actual and potential impact of costs
        - available alternatives at the firm
        - any other relevant factor under the circumstances
    - puts the client's interest first

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

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

We propose guidance in 31-103CP with respect to our expectations as to how registrants may meet their enhanced suitability obligations. We clarify that, in order to ensure that the suitability obligation has been met, our review will be undertaken on the basis of what a reasonable registrant would have done under the same circumstances.

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

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

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

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

- specifying that all conflicts of interest must be addressed, not only those that are material,
- expressly applying conflicts of interest obligations to registered individuals, as well as their sponsoring firms,
- adding guidance relating to particular conflicts of interest, such as conflicts arising from sales and incentive practices and compensation arrangements, including the acceptance of compensation from third parties (such as embedded commissions) and the use of proprietary products,
- restricting certain referral arrangements, and
- expanding recordkeeping in Part 11, particularly as it concerns sales practices, compensation arrangements and other incentive practices.

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

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

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

- 13.4 [*A registered firm's responsibility to identify conflicts of interest*] and 13.4.1 [*A registered individual's responsibility to identify conflicts of interest*] – new and revised sections

- expanding the obligation to take reasonable steps to identify *all* conflicts of interest (including those that are reasonably foreseeable) beyond those that are material
- specifying that the obligation applies to both registered firms and registered individuals
- requiring registered individuals to promptly report conflicts of interest they identify to their sponsoring firms

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

- 13.4.3 [*A registered individual's responsibility to address conflicts of interest*] – new section imposing on registered individuals the same obligations as set out in section 13.4.2, and also providing that they must not proceed with any activity related to an identified conflict of interest unless that conflict has been addressed in the best interest of the client and they have received the consent of their sponsoring firm

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

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

Division 3 [*Referral arrangements*]

- 13.7 [*Definitions – referral arrangements*] and 13.8 [*Permitted referral arrangements*] – expanded to
  - prohibit payment of a referral fee by a registrant unless
    - the party receiving the fee is also a registrant
    - the referral fee is compliant with new section 13.8.1

        - the terms of the referral arrangement are set out in a written agreement between the firm, and the other party to the referral
        - the registered firm records all referral fees
        - the registered firm ensures that the information prescribed by subsection 13.10(1) [*disclosing referral arrangements to clients*] has been provided to the client in writing

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

Division 7 [*Misleading communications*]

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

We also propose extensive new guidance in 31-103CP with respect to our expectations as to how registrants could meet enhanced conflicts of interest obligations. The guidance addresses, in view of the proposed elimination of the materiality threshold in section 13.4, the spectrum of materiality of conflicts of interest and our expectations concerning immaterial conflicts.

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

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

RDI – Part 14 [Handling client accounts – firms], Division 2 [Disclosure to clients]
We have identified shortcomings in the relationship disclosure information that some clients receive from their registrants, despite the fact section 14.2 provides that: "A registrant must deliver to a client all information that a reasonable investor would consider important about the client's relationship with the registrant" and sets out a list of mandated disclosures.

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

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

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

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

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

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

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

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

New Division 1.1 [*Publicly available information*]

- 14.1.2 [*Duty to provide information*] – new requirement that a registered firm must make publicly available information that a reasonable investor would consider important in deciding whether to become a client of the firm, including general descriptions of:

- the products, services and account types that it offers
- any material limitations or restrictions on what is made available (e.g., minimum investments, qualified purchaser etc.)
- charges and other costs to clients
- any minimum account sizes or minimum charges
- any third-party compensation associated with the firm's products, services and accounts

Division 2 [*Disclosure to clients*]

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

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

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

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

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

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

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

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

The Proposed Amendments would add:

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

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

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

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

The Proposed Amendments include:

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

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

Exemptions

The Proposed Amendments do not apply in the following situations:

- for registrants dealing with certain permitted clients, the Proposed Amendments relating to suitability and KYC requirements do not apply;
- for registrants dealing with clients in the context of order-execution-only ("discount brokerage services"), and portfolio manager directed trades, suitability and related KYP requirements do not apply;
- for registered investment fund managers, conflicts of interest obligations set out in sections 13.4 to 13.4.5 do not apply in respect of investment funds that are subject to National Instrument 81-107 *Independent Review Committee for Investment Funds.*

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

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

Transition

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

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

We invite your comments on this schedule.

Questions

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

Transactional relationships

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

Conflicts that must be avoided

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

Referral fees

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

Local Matters

Annex E includes, where applicable, additional information that is relevant in a local jurisdiction only.

Request for comments

We welcome your comments on the Proposed Amendments.

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

Address your submission to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55

Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

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

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of the written comments received during the comment period. All comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the Autorité des marchés financiers at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Questions

Please refer your questions to any of the following:

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