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COMPLIANCE & LEGAL
SECTION

CSA Consultation Paper 33-404

*Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives
Toward Their Clients*

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Background

- Original Consultation Paper published October 2012
- Revised Consultation Paper published April 2016
- Roundtables now in process

CSA Targeted Reforms

- Conflicts of Interests
- KYC
- KYP – Firm and Representative
- Suitability
- Relationship Disclosure
- Proficiency
- Titles
- Designations
- Role of UDP and CCO
- Statutory Fiduciary Duty when Client Grants Discretionary Authority

Overarching Concerns with Targeted Reforms

- Lack of any cost-benefit analysis
- Fails to recognize IIROC robust requirements
- Fails to recognize wide spectrum of clients – not everyone wants or needs a personal recommendation in respect of every decision or full advice involving a comprehensive fact find and assessment across their financial circumstances and needs
- Will create an advice gap
- Will introduce complexity, uncertainty and cost without meaningful benefits for investors

Conflicts of Interest Targeted Reforms

- IIROC already has Rule 42 that conflicts must be addressed in a fair, equitable and transparent manner that is consistent with the best interest of the clients
- An extremely detailed “conflicts of interest management system” imposed
 - Report conflicts to Board
 - Keep a conflict of interest inventory updated
 - Disclosure to clients - client must “fully understand the implications and consequences of conflict”
 - Informed and specific consent before every transaction

KYC Targeted Reforms

- IIROC has clear KYC requirements in Rule 1300, 2500 and Form 2 and relatively new RDD
- Want collection of more detailed information – i.e. status of dependents, basic tax position, total indebtedness (such as applicable interest rate on a loan)
- Specific tax strategies – akin to a FP or tax planner
- Challenging today to get all KYC info and CSA wants it updated every year (signed and dated)
- Level of detail rising to that of a portfolio managed account – may not be necessary or beneficial for all accounts and all clients
- Spend more time completing KYC than advising clients

KYP Targeted Reforms

KYP Representative

- Advisor must understand the structure, product strategy, features, cost and risk of each security in firm's product list
 - Impossible to have proficiency of entire universe of products on the shelf
 - Consequence will be firms will narrow products and leads to:
 - Reduced diversification
 - Reduced portfolio options available to clients
 - Widening advice gap with imposition of minimum account size or accepting only low risk clients
 - Higher fees to offset reduced sales
 - Diminished access to products that benefit small investors
 - Removal of competitive products from shelf
 - Hinder idea generation of investor products
 - Diminished capital raising ability in Canadian marketplace

KYP Targeted Reforms

KYP Firm

- Firms must engage in a market investigation, product comparison and optimization process every 12 months
 - “intended outcome” will ensure range of products offered by firms that present themselves as offering more than proprietary products is representative of a broad range of products suitable for their client base
- Quashes innovation and flexibility
- How does this achieve its objective?
- Business decision and competitive issue for firms

Suitability Targeted Reforms

- Must consider “basic financial suitability” – such as whether it is better to pay down high interest debt or direct cash into savings account
- Advisor to determine if “non-securities product strategies” are more aligned with client or if it is advisable to refer client to insurance or banking
- Again, moving advisors to have proficiency as FP or credit counselor
- Outside current regulatory framework – based on trading or advising *in securities* – change in registration categories and proficiency requirements?
- How is it determined if person with debt would have been better off investing or pay off debt?

Relationship Disclosure Targeted Reforms

- IIAC members have made significant changes to RD as result of CRM
- Additional changes not necessary
- Advisors should have "reasonable basis for concluding that a client fully understands the implications and consequences for the client of content being disclosed"
- How do advisors prove this onus?
- New RD would require disclosure of proportion of proprietary products offered

Proficiency Targeted Reforms

- Must understand the basic structure, features, product strategy, costs and risks of *all types of securities* such as equities, fixed income, mutual funds, other investment funds, exempt products and scholarship plan securities
- A new universal level of proficiency?
- Too broad and unworkable

Titles and Designation Targeted Reforms

- IIAC supports limiting range and number of titles currently used in industry
- Working on providing CSA with an alternative to what they have proposed
- "Restricted securities advisor" not useful to clients
- Advisors only selling prop products would be called "securities salesperson" would apply to a PM

Role of UDP and CCO

- Generally consistent with IIROC rules and practices
 - IIROC Rule 38 Compliance and Supervision
 - IIROC Guidance Note on the Role of Compliance and Supervision

“Regulatory” Best Interest Standard

- CSA indicates different from a fiduciary standard, but unclear what is really intended
- What does it look like? A “standard of care” with the following principles:
 - Avoid or control conflicts of interest in a manner that prioritizes the client’s best interest
 - Provide full, clear, meaningful and timely disclosure
 - Interpret law and agreements in manner favourable to client’s interest
 - Act with care
 - Act in BI of client – requires them to always act in a manner that is focused on achieving what is best for their clients

Overarching Concerns with Best Interest Standard

- Not waiting for CRM2 or POS
- Never undertaken a cost-benefit analysis
- Robust rules exist for IIROC registrants – what gaps can be more specifically addressed
- Legal impact unclear
- In Enforcement proceedings will compliance with IIROC rules and securities law provide a defence?
 - The paper suggests not. The best interest standard is an “overarching” obligation, in addition to other regulatory requirements. If it is not a defence, this creates a huge degree of uncertainty for registrants.
- Impact on civil negligence claim and exposure to damages
 - In civil negligence claims against brokers, the courts determine what standard of care the broker was expected to adhere to by reference to securities legislation and the rules of the SROs. If the statutory regulatory standard becomes “best interests”, what used to be a negligence standard (failure to exercise due care) will be elevated to a fiduciary standard of care (duty to act in client’s best interests) applicable to ALL registrants. At a minimum, this will spawn more civil litigation, more exposure to damages for firms, and create more legal uncertainty and cost for registrants.

Issues with Best Interest Standard

Discussed in CSA Consultation Paper

Expectation Gap will NOT be closed

- Clients may expect that all registrants have an unqualified duty to act in their best interests but some conflicts will still be permitted
- Different business models and registration categories
- How will a BI be imposed on order takers?
- BI standard on a client wanting to purchasing small RRSP amount at bank branch?
- How will conflicts be avoided with proprietary trading?
- How will conflicts be avoided with IPOs or bond trading?

FUNDAMENTAL CONFLICTS IN THE BUSINESS WILL STILL CONTINUE

- Will result in clients absolving themselves of any responsibility for their investment decisions

Issues with Best Interest Standard

- Vague standard
- Legal Uncertainty
- Reduced Choice
 - firms selling proprietary products, or high risk products – contrary to a best interest standard
 - Shift all clients to managed accounts to reduce risk
- Decreased Affordability of Advice
 - New legal, compliance and supervisory requirements will increase cost of advice for clients
- Reduced Access to Financial Products
 - Principal trading provides liquidity
 - Small or mid cap IPOs
 - Junior resource companies, venture issuers, structured products, options
- Leads to negative impact on certain business models and on capital raising
- Supervision and Compliance burden
 - How will it be possible for supervisors and compliance to review for compliance with a best interests vs. suitability standard?
 - Reviewing for best interests is qualitatively and quantitatively different than reviewing for suitability.

CSA Position on Banning Embedded Commissions

- Original Consultation Paper released in 2012
- CSA set to release new consultation before end of 2016
- Proposing to ban embedded commissions
 - Based on independent research
 - Experience in other jurisdictions
- Unintended Consequences
 - Increase advice gap
 - Burden for firms who have just implemented CRM2 and POS

Thank You for Attending Today's Event

QUESTIONS?