October 19, 2018

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 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

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Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment on Client Focused Reforms to Enhance the Client-Registrant Relationship

The Private Capital Markets Association of Canada ("**PCMA**") is pleased to provide our comments in connection with the Canadian Securities Administrators' ("**CSA**") Client Focused Reforms to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations ("**NI 31-103**") and its Companion Policy 31-103CP ("**31-103CP**") (the "**Proposal**" or "**Client Focused Reforms**") as set out below.

About the PCMA

The PCMA is a not-for-profit association founded in 2002 as the national voice of the exempt market dealers ("**exempt market dealers**"), issuers and industry professionals in the private capital markets across Canada.

The PCMA plays a critical role in the private capital markets by:

- assisting hundreds of dealer and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in depth educational opportunities to the private capital markets professionals;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies and other industry associations and public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at www.pcmacanada.com.

The first section of the letter presents our general comments on the Proposal, followed by responses to specific topics within in the Proposal.

GENERAL COMMENTS

From Targeted Reforms to Client Focused Reforms

The PCMA welcomes the Proposal and its potential to enhance the relationship between clients and registrants. The PCMA submitted a comment letter to the CSA on September 29, 2016 in connection with the *CSA Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives towards their Clients* (the "**Targeted Reforms**"). The following is a link to this submission for easy reference: https://cdn.ymaws.com/www.pcmacanada.com/resource/resmgr/comment_letters/pcma_of_canada_-_response_le.pdf. Where relevant, we refer to our comments made in the context of the Targeted Reforms.

The PCMA while pleased the best interest standard has been removed as a proposal; we are concerned that its replacement, the "client interest first" concept, suffers from the same defects as the best interest standard, in the proposal surrounding suitability. Our comments made in relation to the best interest standard at the time of the Targeted Reforms remain apposite, and are repeated here in respect of the client interest first concept.

Gaps in the Paper

The PCMA is concerned there was no prior CSA consultation or advance notice about possible changes to the existing referral rules under NI 31-103 ("**Existing Referral Rules**"). The PCMA submits that further research and analysis should be undertaken by the CSA before it makes a fundamental change to the Existing Referral Rules.

Reconciling the written letter of the law with regulatory staff guidance statements and conduct is important for an efficient marketplace, and the PCMA hopes to see this continue as a theme of regulatory reform. The myriad of resources that a registrant or potential registrant must examine in order to understand both the laws as they are written and the interpretive philosophies employed by regulatory staff create an efficiency barrier that should be avoided wherever possible. The PCMA sees the additional guidance to 31-103CP within the Proposal as an opportunity to reduce such inefficiency.

We are however, concerned that the specific language of certain sections of the Proposal create ambiguities that may result in differing interpretations among industry participants and, depending on that interpretation, may be inappropriate for exempt market dealers as a unique registrant category. These interpretive ambiguities should be clarified before the Client Focused Reforms come into force or we foresee the CSA dealing with two recurring problems: (a) lack of perceived compliance based on failed interpretation as they are written, and (b) interpretive regulatory arbitrage where certain registrants or CSA members interpret the instrument in a less restrictive manner than others.

Prescriptive Guidance

We note that in certain respects the CSA has moved towards a more principles-based approach to regulation with the Proposal than with the Targeted Reforms, which we view as a positive change. We do note there has been some prescriptive requirements considered in the Targeted Reforms moved to proposed 31-103CP guidance. There are some sections where principles and prescription are mixed and there are requirements and guidance that may be conflicting or cause confusion.

We are concerned that the CSA has gone beyond prescription and dictated commercial terms in relation to referral arrangements which we believe may beyond the mandate of the CSA.

Striking the Balance

There is a palpable risk the CSA has not balanced its dual mandate of protecting investors and fostering fair and efficient capital markets. Starting with the working title “Client Focused Reforms” combined with the apparent absence of any quantitative analysis of the cost to the industry, the CSA diminishes the impact the Client Focused Reforms will have on dealers and advisers and their representatives. Moreover, the CSA seems to equate ‘expected regulatory outcome’ with ‘investor returns’. The suggestion that investment returns are correlated with regulatory outcomes is problematic.

Value of Advice

There appears to be a pejorative connotation that the CSA only views dealers and advisers as a cost to investors. The value of advice, the cost of regulation, and the human resources cost to the industry is not recognized in the Proposal. Competition, market forces and profit have a valid and important role in raising capital to drive an innovative economy and ultimately create jobs.

The Unique Business Model of Exempt Market Dealers

The private capital markets are unique and distinct in many ways from the public capital markets but they are just as vital and important. PCMA members vary in size, industry specialization and geographic scope. Some are issuers. Some may represent a significant number of issuers at a time. Some may represent only one issuer at a time and some will go for periods representing no issuer. The Proposal must be flexible enough to accommodate and be proportionate to the various business models and types of registrants involved. To effect this goal, the guidance provided in the Client Focused Reforms to 31-103CP should be enhanced and augmented in relation to the private capital markets.

Exempt market dealers are transaction based. Clients typically seek to access private capital market investments through an exempt market dealer. Clients do not expect exempt market dealers to provide financial planning or portfolio management services. These services are outside of the exempt market dealer registration category and that distinction is missed with the ‘one-size fits’ all approach taken in the Client Focused Reforms.

Cost Benefit Analysis and Alternatives Considered

We are concerned by the lack of quantitative cost-benefit analysis. The Proposal does not consider any alternative regulatory approaches. The CSA does not state how it will (or even can) measure the success or failure of the conflict of interest-related reforms.

Schedule 1 of Annex E of the OSC version of the Client Focused Reforms is the OSC's documentation of how it met the requirements of the Ontario *Securities Act* to provide a description of the anticipated costs and benefits of the proposed rule. Schedule 1 bears the title "Regulatory Impact Analysis of the Reforms to Enhance the Client-Relationship Relationship (Client Focused Reforms)", it does not mention cost and benefit. There is no mention of consultations with registrants or service providers about the dollar and human resource costs of implementing the Proposal. Similarly, there is no mention of consultation with investors to try to quantify the benefits to them.

Such significant changes to regulations warrants both a quantitative and qualitative cost-benefit analysis. In our opinion, Schedule 1 is a purely qualitative discussion on costs and benefits. A concerning statement in Schedule 1 is the statement "We anticipate that this added clarity would improve the effectiveness of enforcement actions addressing concern 5…" We feel enforcement cases should be related to bad actors, not used as an indication of overall registrant behaviour or the successful oversight of the CSA. The purpose of regulatory changes should not be to improve the effectiveness of enforcement actions, but rather to provide clarity and insight necessary to help registrants to *avoid* enforcement actions.

PCMA members include exempt market dealers that are members (or affiliates) of IIROC and MFDA members. The rules of these SROs require conflicts of interest to be resolved in the best interests of the client. We suggest the CSA could have looked to those models and the language in their rules when considering any reforms to rules relating to conflicts of interest.

The CSA states the *status quo* is not satisfactory and for that reason rule-making was the only alternative considered. The fact is there are other alternatives such as, enforcing the current rules. The OSC noted in its registrant outreach program concerning the Targeted Reforms that most of the changes were already covered by existing rules. As noted in the line from the 'description of benefits'; the CSA sought more regulation rather than better enforcement to be the best alternative.

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CLIENT FOCUSED REFORMS

The PCMA offers the following comments and where appropriate recommendations, on the Client Focused Reforms.

KNOW YOUR CLIENT

General

The PCMA feels the Client Focused Reforms involving the KYC requirements of section 13.2 are for the most part a positive step by the CSA. These revisions clarify regulatory expectations surrounding registrant conduct, and facilitate a better understanding of client needs by registrants, including expectations and circumstances before making recommending investments. There has been an abundance of regulatory guidance on the topic of KYC information collection since the implementation of NI 31-103, the KYC proposals codify existing customary and usual practices.

KYC for conducting suitability determinations

In an industry where there are many business models, KYC must remain a principles-based requirement to accomplish the objective of serving suitability. The section titled "Tailoring the KYC process" in the proposed changes to 31-103CP is welcomed. Acknowledging that "what constitutes sufficient information required to support a suitability determination will vary according to… the client's personal and financial circumstances, the client's investment needs and objectives and the registrant's business model" is a an important addition to the KYC collection process.

We recommend CSA Staff include examples in the proposed changes to 31-103CP outlining when more or less KYC information would be appropriate. This will allow registrants to anticipate how the regulators intend to apply the KYC requirements across the diverse business models and relationships between registrants and clients.

If the purpose of KYC information collection is to ultimately assess the suitability risk of an investment recommendation or decision, then only that information which is pertinent to the assessment should be collected. Aggregating superfluous information may be encouraging clients to seek self-directed investment platforms to avoid what may be considered time-consuming and unnecessarily invasive disclosures. This will also serve to mitigate privacy breach risks by avoiding unnecessary information collection.

The KYC provisions must avoid becoming a form requirement, and instead remain a tool only used to the extent it serves a core investor purpose. Section 13.2(2)(c) explicitly states that the new information requirements are for the purpose of allowing a registrant to discharge their suitability determination obligation. The collection of non-pertinent information directed in the proposed changes to 31-103CP or a staff notice should not create a perceived breach of the Instrument.

Financial circumstances and liquidity needs

The specific identification of "liquidity needs" in 31-103CP as a component of the financial circumstances data that must be collected under proposed section 13.2(2)(c)(ii) is a valuable addition for exempt market dealers. This concept recognizes the unique nature of most private investments that are not freely traded on a market or exchange. However, as "liquidity" is not a legally defined term, the PCMA recommends the CSA provide guidance to create a common understanding of this term as it applies to KYC collection. Examples in the proposed changes to 31-103CP would be useful.

The presumption that all publicly traded securities are liquid is incorrect, as is the presumption that all securities purchased by way of an exemption from the prospectus requirement are illiquid. For example, very thinly traded stocks found on the TSX Venture Exchange, NEO Exchange or Canadian Securities Exchange may be harder for a client to liquidate at a reasonable valuation than certain private investments sold by prospectus exemption that carry reasonable redemption rights where the underlying pool of assets is either sufficiently cash-generating or liquid itself. Moreover, private placements of freely trading securities on an exchange, may ultimately become liquid after expiration of the Restricted Period under National Instrument 45-102 – *Resale of Securities*. We are hopeful the concept of liquidity will be something that can be evaluated based on the actual attributes of each investment and not preconceptions.

Collecting information from clients becomes further complicated when the liquidity of securities may not be known to a registrant, or which cannot be sold by a registrant. Guidance relating to the concept of liquidity will allow registrants to firstly, educate their clients and secondly, rely on their clients' assessment of the liquidity of an investment without the registrant advising on securities for which they do not have KYP or in some cases appropriate registration.

The PCMA agrees with the principle in the proposed changes to 31-103CP suggesting that registrants should obtain a breakdown of financial assets and net worth as part of the KYC process. We recommend examples to clarify regulator expectations. PCMA members want to ensure this requirement will not result in the need to understand securities for which registrant did not sell or may not be appropriately registered to provide advice. In the private capital markets information on a security may not be readily available or the issuer may not make the information available to a registrant that was not involved in the initial distribution as the information may be confidential or proprietary.

The PCMA proposes the examination of "financial assets" be tailored depending on the category of registration. What constitutes a reasonable financial breakdown means to an exempt market dealer, to an investment dealer and to a portfolio manager should be considered differently.

Investment objectives

A client's investment objectives are also necessary to KYC but there is a concern with expecting registered dealers and their representatives to translate these objectives into "specific and measurable" goals. We are especially concerned that setting out "an investment return that would be required to meet the client's financial goals" as set out in the proposed changes to 31-103CP could be construed as a violation of section 38.2 of the Ontario *Securities Act*.

The proposed changes to 31-103CP requires dealing and advising representatives to consider the other priorities of clients such as paying down high interest debt or directing cash into a savings account. This is not the role of a dealing or advising representative or areas of their training and expertise. Registrants work with investors to find suitable investments, not to determine whether or not they should be investing. Most registered dealing representatives are not, nor are they required to be, certified financial planners.

The PCMA believes that the Client Focused Reforms should not require registrants to perform activities for which they do not have the required proficiency.

Risk profile

The amendment to change from "risk tolerance" to "risk profile" should have a positive impact on the investing experience of clients. Risk profile is a more objectively based assessment of both a client's capacity for loss and their willingness to accept loss. However, in this section the proposed changes to 31-103CP suggests it is the responsibility of a registrant to identify strategies for clients for which they may not have the required proficiency, such as, financial planning.

Confirmation of information

Under proposed section 13.2(3.1) registrants will be obligated to take reasonable steps to obtain a client's confirmation of the accuracy of the KYC information collected. This is a positive step for mitigating confusion between registrants and clients for what can be a complex data-gathering stage of the relationship.

We recommend clarification in the proposed changes to 31-103CP that by signing or receiving a client's acknowledgment, the information is confirmed as accurate by the client. The client would not confirm the accuracy of any supplemental notes and information collected by the registrant during the KYC process. The Client Focused Reforms should allow registrants to create personal notes that do not form a part of the KYC information reviewed and signed by the clients, but still form part of the registrant's books and records.

Keeping KYC information current

The requirement to keep KYC information current is a logical one, but the proposed changes relating to KYC are not clear in their requirements. The PCMA believes that section 13.2(4.1)(iii) is the right provision as it applies to exempt market dealers. An exempt market dealer's relationship with their clients is typically transactional in nature, and KYC information has no value absent a pending transaction for which suitability can be determined. This aligns with section 13.3(2)(c) requiring certain KYC information solely to the extent it is needed to conduct a suitability determination.

The pragmatism of this section is lost to the overriding requirement in section 13.2(4) that a registrant must take reasonable steps to keep KYC information current. The value and relevance of a such a requirement in the context of a one-time sale of a high quality but illiquid investment is elusive. The PCMA does not agree with the 'one-size fits all' approach is taken in section 13.2(4). We recommend deleting section 13.2(4), or alternatively, moving section 13.2(4.1) to the companion policy as an interpretive guide for the word "reasonable". We have a further interpretive concern in the wording of sections 13.2(4.1)(i) and (iv) which also appear to apply exempt market dealers.

KYC from a privacy risk perspective

The KYC obligation is a collection of personal information. Obtaining better and more detailed KYC information can serve suitability analysis and help protect investors from predatory sales practices on the extreme end, and simple bad investment decisions on the less extreme. But a culture of "collect more personal information" comes at a risk to privacy perhaps now more than ever as businesses continue to transition to electronic platforms and data storage to mitigate the ever-increasing burden of data-aggregation compliance.

The more information that industry is forced to collect from clients as a requirement to do business under laws created by our regulators and governments, the more that information is being put into potentially vulnerable situations from a cybersecurity perspective. The CSA has to serve potentially conflicting objectives of protecting investors by collecting more information and protecting those clients from the privacy risks of having mass aggregated personal information. The PCMA trusts that this has been considered extensively by the CSA before determining that the proposed amendments to KYC requirements are fundamental to client protection.

KNOW YOUR PRODUCT ("KYP")

General

The PCMA supports the proposed KYP requirements in the NI 31-103. As KYP is necessary to determine the suitability of an investment, it has always been done by registrants. These new provisions clarify regulatory expectations surrounding registrant obligations to conduct due diligence before approving products and recommending investments to clients. Similar to collection of KYC information, there has been an abundance of regulatory guidance on the topic of KYP and product diligence since the implementation of NI 31-103. Many of the KYP proposals in the Client Focused Reforms codify existing customary and usual practices.

Comparison with similar securities in the market

The obligation of a firm to compare a security with similar securities is logical, but has practical challenges. In the case of comparing one prospectus-exempt security with another prospectus-exempt security, this could be problematic due to lack of publicly available data. Exempt market issuers do not have the same disclosure obligations as reporting issuers. As private companies, corporate information may not be readily available. This information asymmetry is something that needs to be better acknowledged and reflected in the Proposal.

The proposed changes to 31-103CP does not provided a lot of clarity to this issue, expecting the security to be "compared to a reasonable range of similar investment opportunities". The PCMA recommends the CSA put examples in the proposed changes to 31-103CP of reasonable comparisons including for prospectus-exempt securities.

Formally approving and monitoring securities

The PCMA agrees with the concept of formally approving securities made available for sale, as this has been a customary and usual practice among exempt market dealers. We generally agree with monitoring previously approved securities, however, exempt market dealers are limited in what they can do. It is unclear what would be considered sufficient monitoring in the case of prospectus-exempt securities.

For example, if the issuer only used the accredited investor exemption and does not voluntarily provide updates or financial statements. As noted above, these are private companies and the information is not readily available. The PCMA would hope the reasonable efforts standard would include reviewing available information and asking reasonable questions of issuers. We would suggest examples in the proposed changes to 31-103CP to outline the regulatory expectations in such situations.

The changes to 31-103CP indicates that part of the purpose of re-evaluating securities is to determine whether securities are still appropriate for clients to hold. This could pose particular challenges for exempt market dealers. Firstly, exempt market dealers are transaction based and generally do not hold or have access to client assets or securities. Secondly, as prospectus-exempt securities are generally illiquid, re-assessing the security is somewhat irrelevant if clients are unable to redeem or sell that particular security. Thirdly, National Instrument 45-106 *Prospectus Exemptions*, makes it clear, at least in the case of accredited investors, that monitoring of the client is not required to ensure the accredited status is maintained. Therefore, it could be in the future that an investment in an exempt security may not be suitable due to a change in employment circumstances but would otherwise be suitable.

The PCMA recommends that exempt market dealers be exempted from this requirement.

Maintain an offering of securities and services

The PCMA supports the principles-based requirement that a registered firm must maintain an offering of securities and services that is consistent with how it holds itself out. The PCMA recommends the regulators take a holistic view, rather than imposing a percentage of securities that may not fit with the primary way the firm holds itself out.

For example, some exempt market dealers largely promote they offer opportunities to invest in private securities, however, on occasion, they will participate in non-brokered private placements. We would hope this requirement would be considered to be met as long as the majority of securities and services, based on various measures, fall within the scope of how a firm holds itself out.

KYP obligations of registered individuals

The PCMA supports and agrees with new section 13.2.1(3) which set out the obligations for registered individuals in relation to KYP. The section is consistent with the scads of regulatory guidance on the topic of KYP and product diligence and codifies existing customary and usual practices.

Transfer of securities

Under the Proposal, a registrant must not allow a client to transfer a security from another firm unless the same KYP requirements are followed. As in other situations, a 'one size fits all' approach may pose challenges for exempt market dealers due to the nature of private securities. For example, the information to conduct KYP may not be publicly available, and an issuer may not be willing to provide this information to an exempt market dealer as the information may be confidential and/or proprietary.

It may be beneficial to emphasize the reasonable steps wording of this section; exempt market dealers should try to obtain the required information, with the understanding that it may not always be possible to do so. Examples in the proposed changes to 31-103CP would be beneficial.

SUITABILITY

Client's interest first

The PCMA is concerned that in respect of section 13.3(1)(b) the client's interest first standard (**"Client First standard"**) is ambiguous (as was the proposed best interest standard) and that the ambiguity could be argued to be a guarantee against investment risk or business failure. This term is not commonly used and without precedent and it is not defined in the proposed changes to 31-103CP.

We have concerns that the Client First standard created by the CSA will put the onus of investment failures, or the failure of a particular investment to meet its objectives on registrants.

The Regulatory Impact Analysis in Annex E in the Ontario version of the Proposal on page 255 supports our concern:

> "Finally, the proposed requirements to put the client's interest first as well as the addition of relevant factors to consider bring more clarity to what is expected of the suitability process. **We anticipate that this added clarity would improve the effectiveness of enforcement actions** addressing concern 5, *Clients are not getting outcomes that the regulatory system is designed to give them*."
> (bolding added)

As noted by IOSCO in its principles of regulation, "regulation should not be expected to remove risk from the capital markets, but it should ensure proper management of that risk". There are a myriad of reasons for suitable investments to fail but under the Client's Interest First standard the registrant could be held liable for losses for not recommending the single security that put the client's interest first. The CSA should include several examples in the proposed changes to 31-103CP which illustrate the requirement (how this concept is met and not met in the context of a suitability assessment of an investment). The single example of not deploying cash in a managed account is not relevant or helpful for registered dealers.

Prescriptive regulation

The PCMA raised concerns in its comment letter on the Targeted Reforms about the CSA moving to prescriptive regulations. In the case of suitability, the CSA appears to have moved to prescriptive regulation and a one-size fits all approach. Section 13.3(1)(a)(i), (ii), (iii) and (viii), that is, KYC, KYP, features and costs, and other relevant factors, are more or less the standard review for registered dealers to determine suitability. Item (vi) potential impact of costs appears to be covered in (ii) KYP and (iii) costs.

We are not sure whether a "reasonable range of alternative actions" in item (vii) is meant to be the same as a "reasonable range of similar investment opportunities" referred to in the KYP section. If it is, then it is already covered in consideration in item (ii). We recommend examples of reasonable range of alternative actions be included in the proposed changes to 31-103CP.

Diversity of investments and liquidity across all of the client's accounts at the firm (items (iv) and (v)) are relevant for portfolio managers and investment dealers. But as acknowledged on page 255 of the OSC version of the Proposal, many exempt market dealers do not have ongoing relationships with clients. Exempt market dealers offer limited products many that are illiquid and sometimes only products issued by related party issuers. In these instances, many clients of an exempt market dealer will buy only one product. In such instances, it will be hard to argue that the client is not over-concentrated in the "client's accounts at the firm".

The requirement in section 13.3(1)(a)(v) seem to be inconsistent with the guidance in proposed 31-103CP which refers to using the portfolio approach to suitability. The client's total investment portfolio should be considered including accounts outside of the registrant. Dealing representatives can and do ask the client for disclosure of their investments outside of the registrant. However, a dealing representative is at the mercy of the client for full and accurate disclosure. Conducting a suitability determination with these additional items will be difficult to meet by exempt market dealers.

The PCMA agrees that investments must be suitable but does not agree with the prescriptive approach to suitability in the Client Focused Reforms. We recommend moving the itemized list under section 13.3(1)(a) to the proposed changes to 31-103CP. There are cases where all these factors cannot be satisfied, yet making the trade would be putting the client's interest first. For example, a senior may have a concentration in a fixed income security that would result in the trade being unsuitable under this prescriptive test. However, where the income from the investment is paramount to the daily necessities of the client, and provided the client is aware of and accepts the investment risk, it should not result in a finding of improper concentration.

CONFLICTS OF INTEREST

General

The PCMA agrees that the conflicts of interest requirements are fundamental registrant conduct obligations that inform and protect investors. We support a Client First standard *only* in relation the CSA's objective of creating an obligation to respond to an identified conflict of interest. We note there are precedents for using this standard to address conflicts of interest and it would result in harmonization with SRO rules.

Adopting a Client First standard and not a Best Interest standard for conflicts of interest

The PCMA recommends adopting a Client First standard as it involves a conflict of interest instead of a Best Interest standard as proposed by the CSA. The Client First standard requires a registrant to put the interest of a client ahead of the interest of a registrant. This would be a consistent evolution to the current duty of registrant to act honestly, fair and in good faith towards their clients.

A Client First standard is more easily understood by registrants since it forces the comparison of the interests of two parties, the investor and the registrant, and requires the investor to prevail and have their interests come first in matters involving a conflict.

The PCMA concerns with the CSA's introduction of a Best Interest standard for conflicts involving those registrants who are not in a fiduciary relationship with a client, such as an exempt market dealer.

The Best Interest standard and Client First standard are two different concepts. The PCMA believes the guidance of the what is expected of registrants involving conflicts is adequately addressed in the proposed changes to 31-103CP, subject to our comments below, however, we recommend not including the words "best interest" in NI 31-103 and 31-103CP.

The PCMA appreciates that CSA members have provided detailed guidance in its proposed changes to 31-103CP involving conflicts of interest in order to better articulate its expectations of what is required. The PCMA supports such guidance, however, we are concerned with the specific use of the term "best interest". More specifically, we are concerned that any judicial, OBSI or CSA member interpretation of a Best Interest standard will go beyond what is set out in the proposed changes to 31-103CP involving conflicts which may not be what is intended by the CSA.

This would have a material adverse impact on registrants. In instances where a product has not produced the investment returns an investor desires, an allegation that a conflict was not addressed in the client's best interest could be challenging for an exempt market dealer and its dealing representative, including the time, money and effort it would take to justify their position would be extremely onerous. In context, anytime an investment did not work out, an investor could merely allege a conflict that was not addressed in the client's best interest which would then require the exempt market dealer and dealing representative to expend considerable resources to demonstrate it was appropriately addressed. This burden is too high and puts no responsibility on investors in sharing the responsibility in making an investment decision where a conflict of interest exists.

Moreover, importing a Best Interest standard into a conflict regime has the real potential of becoming similar to a public interest standard, which provides no certainty to registrants or allows them to operate their businesses within reasonable parameters of risk. Accordingly, the PCMA requests the CSA delete reference to the term best interest in NI 31-103 and the proposed changes to 31-103CP involving conflicts and replace it with the Client First standard. The

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proposed changes to 31-103CP involving conflicts, subject to our comments below, would provide adequate guidance and measurably raise the bar for all registrant conduct which would provide better outcomes for investors and registrants.

On a technical note, the PCMA submits that the Best Interest standard and Client First standard are not clearly defined by the CSA which will impact the ability of registrants to comply with their regulatory obligations. We also note the different references to the term "best interest" may inadvertently have different interpretations. We are not sure if this is intended and request clarification. For example, 31-103CP provides for the "client's best interest" while the phrase "best interest of the client" is used throughout Part 13: Division 2 of NI 31-103.

Who determines whether the Client First standard or Best Interest standard has been achieved

Compliance officers of an exempt market dealer review the suitability of a trade. It is not clear how compliance officers will determine whether a Client First standard or Best Interest standard has been achieved as part of their trade review process for suitability. As noted above, the PCMA does not support the use of the Client First standard to determine suitability.

For example, the PCMA submits that compliance officers will first have to determine whether a trade is suitable in a manner that puts the client's interest first. Then the compliance officers will undertake a review of whether any conflicts of interest have been addressed in the best interest of the client; a separate review and analysis and two different tests.

It is not clear how compliance officers can identify all conflicts, including product differences, when reviewing a trade and make a best interest determination. Some compliance officers are not registered as dealing representatives and may not have the training or education to identify, review, analyze and determine whether a conflict is in the best interest of a client. This will likely result in compliance officers 'second-guessing' registered dealing representatives in connection with their recommendations in the face of a conflict. For example, how is a compliance officer to determine whether a product that offers a higher commission was in the client's best interest relative to a product that offered a lower commission?

If not compliance officers, who else would be making such best interest determinations for every trade. This is too great a burden to put on a CCO, UDP or board and would likely result in a reduced product shelf and compliance officers not reviewing every trade. This would be an unintended and negative outcome with reduced investor protection and greater firm risk for noncompliance since not all trades would be reviewed if senior management had to be more involved in trade reviews.

The PCMA submits that a Client First standard for conflicts is consistent and more manageable on compliance officers. A compliance officer and a dealing representative could more easily discuss the concept of whether the client's interest was put first relative to that of the firm or dealing representative than the client's best interest.

Proposed requirement to identify all conflicts of interests

Registrants should only be required to identify *material* conflicts of interest, as required under the existing conflicts rules set out in NI 31-103 and not *all* existing and reasonably foreseeable conflicts of interest. A materiality threshold provides a litmus test for registrants to reasonably identify conflicts of interest. This is consistent with Regulation Best Interest proposed by the United States Securities and Exchange Commission.

Identifying all conflicts puts too great a burden on registrants who may reasonably and innocently fail to identify certain non-material conflicts in the view of a CSA member.

The CSA does not explain why identifying non-material conflicts of interest furthers investor protection. The PCMA does not see any benefit, including increased investor protection, to disclosing immaterial or insignificant conflicts of interest. In our view, the benefit of this must be clearly identified and explained to justify the cost and resources new infrastructure that firms must put in place to meet this new requirement.

Moreover, if investors are subjected to disclosure about any and all conflicts, existing and reasonably foreseeable, they may not understand which ones are more or less important and be overwhelmed with the amount of disclosure. We do not see how this will advance investor protection and is not a reasonable requirement to place on registrants.

The PCMA is concerned the concept of "reasonably foreseeable" places an unfair burden on registrants. It is conceivable that if a registrant innocently failed to identify a conflict, since it believed it was not reasonably foreseeable, it will be held accountable regardless by CSA members. A determination of reasonably foreseeable, after-the-fact, subjects registrants to the differing views of CSA members, OBSI, the judiciary and others on what is and what is not reasonably foreseeable. This only creates a lack of certainty for registrants to run their business within acceptable parameters of risk.

In sum, the PCMA recommends only material conflicts of interest should be identified and addressed in the proposed changes to the conflicts of interest rules under NI 31-103.

Disclosure of conflicts of interest

The PCMA agrees that disclosure of a material conflict of interest should be prominent, specific and clear and should be sufficiently meaningful so that an investor fully understands the conflict of interest. The PCMA agrees that disclosure solely on its own may be ineffective to address a material conflict of interest, especially when certain investors may have low financial literacy.

We appreciate there is evidence that disclosure of a material conflict of interest in isolation may not, in and of itself, be sufficient to discharge a registrant's duties. However, there have been studies which demonstrate that disclosure can be effective when combined with other measures, such as those to reduce certain conflicts, and improve investor outcomes. We note the CSA, in requiring disclosure of non-material conflicts of interest, acknowledges the value of disclosure. We question why clear, concise and material disclosure may not be sufficient to address conflicts of interest in some instances.

What is missing in the Proposal is a mention of any CSA initiative involving increasing investor education which is extremely important as more and more Canadians should have greater responsibility for their investment decisions. It should not be the sole responsibility of a registrant to be the guarantor of investment outcomes when it is part of the risk/reward decision investors make along with their advisors/representatives in making an investment decision. The PCMA believes that individuals must also be accountable and responsible for making investment decisions along with their advisors/representatives, including those involving conflicts when disclosed and/or mitigated just as an individual do with other aspects of their lives, involving any conflict. The PCMA believes there must be a sharing of responsibility and a good investment outcome does not mean that clients are insulated from risk or that a product always makes money.

In our view, where full disclosure of material conflicts of interest has been made with measures added to reduce any conflict, a client should be able to decide whether or not they accept the conflict. Combined with true and full disclosure of the benefits and risks of the investment, the client can make an informed decision, rather than abdicating his or her responsibility, through increased reliance on the registrant, as set out in the Proposal relating to conflicts of interest. The PCMA suggests the CSA has tilted the balance in such matters against registrants, and making them, more or less, guarantors of investment outcomes experienced by investors.

As indicated in the PCMA's comment letter involving the Targeted Reforms, we support a standard conflicts of interest disclosure document ("**COI Disclosure Document"**) for the industry similar to the concept of the Fund Facts document for mutual funds. The COI Disclosure Document would standardize disclosure (but allow each registrant to tailor the document to their particular circumstances). The COI Disclosure Document would include a general, easily understood definition of conflicts of interest, set out the necessary information in a clear and succinct manner, and make it clear to the client that the decision rests with them having the benefit of all of the material information. As with the Fund Facts document, clients would be in a position to compare and contrast conflicts of various registrants. It also recognizes that clients themselves must play a key role in investor protection. We would encourage the CSA to undertake consumer research regarding the best way in which to provide meaningful conflicts of interest information to clients in such a way that it will be read and understood and in a manner that is universally applied by all dealers for the benefit of clients.

Avoiding conflicts

The CSA states that a registrant must avoid a conflict if there are no controls to sufficiently address the risks to a client or insufficient controls. We recommend the CSA provide examples in the proposed changes to 31-103CP the regulatory expectations related of reasonable controls to manage the conflict.

Conflicts arising from proprietary products

The CSA requires registrants to conduct periodic due diligence of comparable non-proprietary products available in the market. As noted in our comments relating to KYP above, the PCMA submits this is impractical and difficult for an exempt market dealer.

Firstly, there is no readily available public information on non-reporting issuers. For example, certain non-reporting issuers file information on SEDAR, such as those filing an offering memorandum under the OM exemption. SEDAR is also not easily searchable. There are also no software filtering tools like Bloomberg or Morningstar that can easily provide comparable information for minimal cost like those available for comparing public companies and mutual funds.

Secondly, the time, money and effort for an exempt market dealer to review, even a single issuer, for purposes of such market survey, is cost prohibitive. For example, information and documents would have to be obtained from an issuer under a non-disclosure agreement. An exempt market dealer would have to access a data room to review and undertake an analysis of such information which would take considerable time, money and effort just to compare similar products in the marketplace. This cost would passed on the clients in some manner, such as, higher fees on other investments. Such a requirement would place firms selling proprietary products at a competitive disadvantage to firms only selling third party products.

Conflicts arising from third-party compensation

The PCMA is concerned that the CSA seeks to have exempt market dealers regulate third-party compensation. Exempt market dealers have little control or power over such matters and they are more appropriately addressed directly by the CSA.

The CSA defines “third party compensation” as any monetary or non-monetary benefit provided, or expected to be provided, directly or indirectly to a registrant by a party other than the registrant's client in connection with the client's purchase or ownership of a security through the registrant. 31-103CP states that the CSA considers circumstances where registrants receive greater third-party compensation for the sale or recommendation of certain securities relative to others to be a conflict of interest. If a registrant is not controlling these conflicts in the best interest of its clients, the registrant must avoid these conflicts.

Similar to public offerings, prospectus exempt offerings disclose compensation to dealers which is determined by the issuer. Issuers do not have common commission rates. The effect of the CSA’s recommendation is to require all issuers to have a common compensation grid. Issuers provide different compensation arrangements for registrants that include, up-front and trailing commissions and back-end interests. It is not clear how an exempt market dealer can dictate what compensation an issuer will pay.

It is unclear how exempt market dealers can act in a client’s best interest if they earn a higher commission for a comparable product. The CSA puts the onus on an exempt market dealer to explain why one product justifies the higher compensation when issuers determine the amount of compensation their business model can afford commensurate with risk and market forces.

However, exempt market dealers can ensure that securities providing third-party compensation or higher third-party compensation are subject to the same know your product processes and selection criteria as other similar securities providing lower levels of third-party compensation or no third-party compensation. The PCMA has no issue with the proposed CSA guidance regarding such matters as this is the customary and usual practice of exempt market dealers.

The proposed changes to 31-103 CP states that comparisons should also be made to those securities that do not provide for any third-party compensation. However, in the private capital

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markets, exempt market dealers only sell products that provide some form of compensation which is different than the public markets.

Conflicts arising from internal compensation arrangements and incentive practices

Exempt market dealers and other registered dealers sell securities. Exempt market dealers are a business and, like other businesses, earn revenue based on sales. We agree with the proposed 31-103 CP that registrants must not recommend a product or service just because it pays them better than other alternatives. This is consistent with a registrant's obligation to deal fairly, honestly and in good faith with its clients.

The PCMA agrees with the guidance proposed 31-103 CP that if certain products or services available at a registrant provide better compensation than others, registered individuals must put their clients' interest first when deciding which product or service to recommend as well as determining that the recommendation is suitable. As a result, the client's interests, not the registrant's interests, must guide the recommendations made by a registrant to its clients.

However, the PCMA submits that the CSA has not provided any guidance on the level of detail and sufficiency of information that an exempt market dealer and a dealing representative generally must provide to demonstrate they acted in a client’s best interest (or put their client’s interest first) when they are paid a higher commission relative to a similar product. Furthermore, it is unclear how an exempt market dealer is to determine the similarities and difference between so called similar products. Examples in the proposed changes to 31-103CP would be useful for registrants.

The PCMA submits that the private capital markets are very different than the public markets which have more homogenous types of products. For example, there can by many similar mutual funds which are easier to compare relative to private market securities which arguably are all different. For example, one can more easily compare two small cap public mutual funds than two private market real estate investment trusts. The PCMA requests that the CSA provide more guidance for exempt market dealers on what is required to undertake appropriate product comparisons in the private capital markets, for example, among real estate issuers.

Conflicts of interests at supervisory level

The PCMA agrees with the guidance in the proposed 31-103 CP that if compliance or supervisory staff's compensation is tied to the sales or revenue generation of the registered individuals that they supervise, this creates a conflict of interest that may cause compliance or supervisory staff to put their interests ahead of the clients' interests. Compliance and supervisory staff may not be able to properly oversee these registered individuals when compensated in this manner.

Registered individual's responsibility to address conflicts of interest

We agree with the CSA's proposal to expressly apply conflicts of interest obligations to registered individuals, as well as their sponsoring firms. Conflicts of interest originate with people and should not solely be a firm responsibility. It is important that individual registrants consider and understand any potential conflicts of interest in the same manner as the firm. We see this as a positive step to identifying and addressing conflicts of interest.

Proposed changes to 31-103 CP states that a registered firm's consent involving a conflict does not automatically mean that the registered individual has satisfied their obligation to address the conflict in the best interest of their client. If a registered individual has received the consent of their sponsoring firm to proceed with the activity, the registered individual must also assess whether that decision is consistent with their client's best interest. This may result in the registered individual deciding to avoid the conflict notwithstanding the firm's consent. Registered individuals and their sponsoring firms each have a distinct obligation to address conflicts in the best interest of the client (we recommend the Client First standard).

Generally, a dealing representative will assume that if an exempt market dealer has provided consent to a conflict that they do not have to avoid the conflict and can manage the conflict in accordance with the guidance provided by their exempt market dealer. The PCMA requests additional CSA guidance on when a dealing representative should avoid a conflict when their exempt market dealer has consented to it.

Compensation conflicts

The PCMA agrees that prior to entering into a transaction with a client, a registrant must disclose any commissions or other compensation that they will be receiving in respect of the transaction.

As discussed above, issuers have no uniform commission payment to exempt market dealers; for example, one issuer may pay an exempt market dealer 6% commission while another may pay 4% commission and 1% annual trailing fee. The PCMA has no objection with providing compensation disclosure to clients.

Many PCMA members who are exempt market dealers sell securities under the Offering Memorandum Exemption where Form 45-106F4 requires the amount of the commission to be disclosed to an investor who must also sign the form.

REFERRAL ARRANGEMENTS

CSA concerns

The CSA provides three main concerns with referral arrangements (page 258 of Annex E in the Ontario version of the Proposal), all of them are related to firms and individuals that are not regulated by the CSA. When unregistered persons conduct registerable activities; the regulators have the powers to act and discipline those persons.

The CSA states as a principle that if an individual is receiving the bulk of the revenues from the registerable activity then that individual should be registered. The regulators have the powers to act against unregistered persons that *conduct* registerable activities.

For registrants, a new client account is handled in accordance with the standard of care to treat clients honestly, fairly and in good faith and in the case of portfolio managers, a fiduciary duty. This is regardless of how the client comes to the registrant: a referral, a cold call, word of mouth or acquisition of a book of business.

The PCMA suggests this reform is not Client Focused, it will impair the ability of investors to obtain investment opportunities and advice. The notice to the Proposal estimates 60% of portfolio managers and 9% of AUM will be impacted. In other words, potentially thousands of clients and billions of dollars of assets may be impacted. In addition, the CSA has not provided an estimate of the dollar or human resources cost to implement this reform.

Support for the Existing Referral Rules

The PCMA is concerned that the CSA has decided to incorporate commercial terms of business in the Proposal. We are not certain how including commercial terms of business meets the mandate of investor protection and fostering fair and efficient capital markets.

When NI 31-103 was first proposed, in a CSA Notice in 2007 (see OSC Bulletin, Volume 30, Issue 8 (Supp-2), February 23, 2007) the CSA had carefully considered referral arrangements. In the Overview section of the notice, it was reported:

> **"Referral arrangements**
>
> The CSA have identified a number of issues and regulatory risks relating to referral arrangements through the course of compliance field reviews and enforcement cases including:

- conflict of interest – there is a risk that the referrer will only refer clients to a registrant that pays for the referral or to the registrant that pays the highest referral fee
- client awareness – a client expects advice that is in the client's best interest and is not influenced by the referrer's own financial interest
- client confusion – without adequate disclosure, clients may be confused about who they are dealing with and who to approach for advice
- referrer performing activities requiring registration – there is a risk that a referrer lacking the appropriate registration may engage in activity requiring registration (e.g. dealing in or advising on securities)
- supervision and oversight – some of the referral arrangements observed during compliance field reviews are informal arrangements that a salesperson have entered into with the dealer's knowledge or approval.

The Rule attempts to address these issues and to minimize the risks relating to referral arrangements. The Rule requires registrants to:

- manage and disclose conflicts of interest
- disclose information about referral arrangements that a reasonable investor would consider important in order to evaluate the referral arrangement
- establish clear lines of responsibility for compliance with securities legislation."

In the same notice, the companion policy reported:

"Referral arrangements

Application

The purpose of Part 6, Division 2 of NI 31-103 is to deal with the abuse, misuse or misinterpretation of referral arrangement relationships involving registrants. There are many kinds of referral arrangements. Some referral arrangements require that one or both parties be registered. Whether a party needs to be registered depends on the activities carried out by the parties to the referral arrangement. There are a number of factors to consider in determining whether an arrangement is a referral that requires registration.

Part 6, Division 2 of NI 31-103 applies to the referral of a client to or from a registrant. A referral of a client also includes a referrer passing a client name and

> contact information to the person or company receiving the referral for a referral fee. A referral fee means any compensation paid for the referral of a client, including sharing or splitting any commission resulting from the purchase or sale of a security.
>
> *Scope of Activities*
>
> Typically, a client will rely on the registrant to have the ability to invest their portfolio and to give appropriate investment advice. Therefore, if a registrant does not have the expertise or the appropriate registration to provide a service, it is expected that the registrant will refer their client to an appropriately qualified person.
>
> Part 6, Division 2 of NI 31-103 applies to any referral arrangement where the registrant is paying for the referral and to referrals from a registrant to a person or company that provides investment products or services, including:
>
> - a mortgage broker for a mortgage
> - a financial planner for financial planning services
> - an exempt market dealer for trading in flow-through shares
> - a portfolio manager for discretionary management services."

The rationale behind the Existing Referral Rules made sense. It identified issues from compliance and enforcement cases and obviously had input from those groups in creating the rule. The notice recognizes the value of advice and also notes the value of obtaining a client base both as valid business reasons for having referring arrangements. Finally, NI 31-103 and 31-103CP currently recognizes unregistered entities could be involved in a referral arrangement.

The Targeted Reforms did not propose any changes to the Existing Referral Rules. In fact, there had been no changes to this section since it was implemented. The section was supported by the Government of Ontario's Expert Committee to Consider Financial Advisory and Financial Planning Policy Initiatives. In its final report published on November 1, 2016 titled *Financial Advisory and Financial Planning Regulatory Policy Alternatives* (the Final Report)[1], it makes the following recommendation in Chapter 8:

> "We recommend that no individual or firm that engages in Financial Product Sales, or Holds Out as providing Financial Planning or Financial Advice, be permitted to enter into a referral arrangement with a third party for the referral of a customer or

[1] See https://www.fin.gov.on.ca/en/consultants/fpfa/

> prospective customer who is to be provided with Financial Planning, Financial Advice or Financial Product Sales, unless the referral arrangement accords with conditions equivalent to those set out in Part 13 (Division 3) of National Instrument 31-103."

This recommendation was supported in 2016 by many financial services participants including IFIC, the CFA Institute, IIROC and Fair Canada. We reference below the quote published in the Final Report from Fair Canada which was not advocating for an outright ban on financial service providers or non-registrants as referral parties.

> "Referral fees should be transparent (the amount of the fees, the impact or consequences of their presence) and should be disclosed to the consumer in plain language before engaging the financial service provider. Any relationship that a financial planner has with others providing financial advice should be reasonable and should be disclosed prior to the engagement." – FAIR Canada (June 2016)

Ontario's Expert Committee recommended referral arrangement conditions equivalent to those set out in Part 13 (Division 3) of NI 31-103. However, the CSA's proposed changes to the Existing Referral Rules would effectively ban any referrals to financial planners. This is inconsistent with Ontario Government policy, and possibly those of other Provincial Governments, and effectively excludes financial planners whose business involves not only receiving fees for providing financial planning services but referrals to registrants. The PCMA submits that the proposed changes to the Existing Referral Rules are overreaching and not required in light of the current requirements, which are supported by various stakeholders including the government as well as industry and investor advocates.

Referrals from non-registrants

The Client Focused Reforms in relation to referral arrangements ignore the value of advice and the value of obtaining a client. These reasons were clearly considered when the Existing Referral Rules were created and they continue to be valid reasons for referral arrangements. This includes referrals between registered entities. For example, a portfolio manager may refer a client to an exempt market dealer for an investment in the private capital markets. Conversely, an exempt market dealer may recommend a client to a portfolio manager to obtain exposure and access to the liquidity of the public capital markets.

The risk of unregistered firms and individuals conducting registerable activates was also considered when NI 31-103 was implemented. It was believed the regulators had the requisite powers to deal with those situations should they arise. This is still true today.

The PCMA submits that prohibiting a registrant from paying a referral fee to a non-registrant will result in harm to investors, not protect them. Currently, many non-registrant entities refer clients to registrants to access to securities related services. Many exempt market dealers and portfolio managers are referral partners with non-registrant entities including the following:

- financial planners;
- mortgage brokers;
- insurance agents;
- family offices;
- accountants; and
- lawyers.

None of these entities are regulated by the CSA. As profit-based businesses, these entities will likely refrain from making referrals to registrants. As a result, investors could be referred to entities where they do not receive the protections afforded through securities legislation. Furthermore, investors could be deprived of choice and in particular, quality investment advice and instead end up with the recommendations of an insurance agent, bank teller, or other person without a securities background.

The CSA should make efforts aimed at educating non-registrants. For example, a CSA Video on best practices and regulator expectations of non-registrants in referral arrangements. The cost of a video today with YouTube is minimal. This will allow the CSA to ensure the type of information a referring party receives including what they can and cannot do, and the implications of certain actions triggering registration or engaging in activities of a registrant. Registrants can be responsible for ensuring non-registrants watch the video and sign an acknowledgement.

Referral arrangements and conflicts of interest

The PCMA disagrees with the assertion that all referral arrangements are a conflict of interest. We acknowledge that a referral is a potential conflict of interest since there is a fee received by the referring party. This is the same conflict that exists in any mercantile transaction. However, where a registrant refers a client to another registrant it is due to the expertise, products and service offered by the other registrant can better serve the interests of a client. The interests of the registrant and the client are not inconsistent or divergent. Therefore, there is no conflict of interest and the referral arrangement does not need be analyzed in that context.

We acknowledge that a referral is a potential conflict of interest since there is a fee received by the registrant and there are several referral options. This rarely happens as when there are multiple referral partners, usually each has a different area of expertise, product and service selection. The choice of referral partner will be made based on the expertise needed by the client. The interests of the registrant and the client are not inconsistent or divergent. Therefore, there is no conflict of interest and the referral arrangement does not need be analyzed in that context.

Selecting an appropriate referral partner is similar to the KYP requirement. For example, an exempt market dealer does not have any special influence over a referral and may refer clients to a number of portfolio managers for various reasons and let the client determine the portfolio manager they want to engage. The important aspect of the referral is that the exempt market dealer undertake appropriate due diligence on the referral party. As noted in the current companion policy:

> "Section 13.9 requires the registrant making a referral to satisfy itself that the party receiving the referral is appropriately qualified to perform the services, and if applicable, is appropriately registered. The registrant is responsible for determining the steps that are appropriate in the particular circumstances. For example, this may include an assessment of the types of clients that the referred services would be appropriate for."

Combined with the other requirements and safeguards in NI 31-103 and 31-103CP, including the disclosure of all fees, it is unclear how the interests of a registrant and a client would be inconsistent or divergent. An analysis that does not fit the situation puts the registrant at risk, will likely further reduce the use of referral arrangements and ultimately investor choice.

Maximum fees

The PCMA submits that regulating the amount and duration of the payment of referral fees interferes with commercial terms of business. The CSA limits on referral fees appears to be arbitrary and impacts the economic arrangement between the referral parties.

A referral fee is purely an economic arrangement that is fully disclosed to clients under the Existing Referral Rules. For example, paying 100% of a registrant's commission/fee to a referring party, does not make economic sense. The Proposal does not recognize the value of advice or the cost of building a client base. For example, specialized services may demand higher fees than routine services. Similarly, a family office is likely to have high net worth clients, and a higher referral fee may be economically feasible based on assets under management.

The definition of "referral fee" was changed where the term "compensation" was replaced with "monetary and non-monetary benefits". The CSA does not define the term "non-monetary benefit" which is also used in other sections of the Client Focused Reforms. The PCMA recommends the term "non-monetary benefits" should be clearly defined so it is understood by all parties. Examples of non-monetary benefits in the proposed changes to 31-103CP would help registrants meet regulatory expectations.

Sunset clause

The Client Focused Reforms seek to limit referrals among registrants to a maximum of 36 months. As with changes to other commercial areas, it appears arbitrary and impacts the commercial arrangement between the parties.

The term of a referral arrangement does not necessarily mean that a referral party is being compensated for any ongoing activities which may raise registration concerns. This is a false assumption. It is purely an economic arrangement. For example, a referral party may not want to pay a lump sum fee and would rather pay over the time of the client relationship. The fee is fully disclosed to clients.

RELATIONSHIP DISCLOSURE INFORMATION

General

The PCMA generally supports the CSA's proposed changes to the relationship disclosure information ("**RDI**") requirements in NI 31-103.

As stated above, the CSA has not defined the meaning of a "non-monetary benefit" in NI 31-103. We note that the Companion Policy to National Instrument 81-105 – Mutual Fund Sales Practices (**NI 81-105**) defines a non-monetary benefit as including any goods, services or other benefits that could be provided to or received by a person or company and that could be perceived by that person as being of benefit, advantage or value to him, her or it. The matters that are included in the term include, without limitation:

- domestic or foreign trips, food, beverages and accommodation, regardless of whether these benefits are provided in connection with attendance at a conference or other event sponsored by a member of the organization of a mutual fund;

- entertainment, including the provision of tickets to concerts, theatre or sporting events, or the ability to participate in events such as golf tournaments;
- gifts and non-cash gratuities;
- invitations to educational seminars or conferences organized by members of the organization of a mutual fund;
- attendance at educational seminars, conferences or courses; and
- computer hardware, including networking hardware and general business software systems.

NI 81-105 was carefully crafted at the time with industry input and carve-outs within the Instrument itself explaining how it was to operate and what was a permitted and not permitted non-monetary benefit.

Simply leaving the term a non-monetary benefit undefined or cross-referencing the term with its guidance in the Companion Policy to NI 81-105 creates uncertainty and negates the benefit of having a larger regime within which the term operates. For example, NI 81-105 specifically provides for, among other things, permitted compensation, internal dealer incentive practices and marketing and educational practices involving sponsored events, which provide guidance on a more holistic basis for acceptable practices involving the receipt of non-monetary benefits.

We recognize the CSA has provided some guidance on its expectations in proposed changes to 31-103CP under the following headings:

- Conflicts arising from third-party compensation
- Conflicts arising from internal compensation arrangements and incentive practices

Notwithstanding the above, the PCMA submits the CSA needs to better understand the compensation practices of exempt market dealers and the nature and extent of any non-monetary benefits. Our concern is that the lack of a regime for non-mutual fund dealer registrants, such as exempt market dealers, creates significant uncertainty on such matters, which is not in the best interest of investors or registrants.

The PCMA requests more time to consult with the CSA regarding such matters and, although we are not advocating for the exclusion of non-monetary benefits from the definition of third party compensation, we are strongly advocating for a consultative process outside of the Client Focused Reforms.

Potential impact of charges in RDI

Paragraph 14.2(2)(o) requires an explanation of the potential impact that a registered firm's charges, applicable investment restrictions, and any costs embedded in investment products could each have on a client's investment returns. The CSA states that the explanation necessarily includes a discussion of the reduced overall returns in the account because of any operating charges and the reduced return on securities resulting from any transaction charges or ongoing ownership fees applicable to them. It also requires a discussion of the potential for reduced overall returns if only a limited range of products is made available to the client.

The PCMA is unclear on the nature and extent of such disclosure as it applies to exempt market securities. The impact on its face is a reduction in returns which generally are not known as many products that provide for a return are typically targeted returns. The PCMA has no issue with such general disclosure but is unable to determine the CSA's expectations and requests guidance.

MISLEADING COMMUNICATIONS

General

The CSA proposes a new division to NI 31-103 involving Misleading Communications that states registrants must not hold out their services in any manner that could reasonably be expected to deceive or mislead any person as to:

- their proficiency, experience, or qualifications
- nature of the person's relationship, or potential relationship, with the registrant
- the products or services provided, or that may be provided

For greater specificity, the CSA states that:

- 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.

Need for Consistency Among All Registrants

PCMA recognizes that the MFDA and IIROC have guidance on titles and Designations, and there is a desire to have some consistency among all registrants. The PCMA is supportive of these changes and supports the efforts by the MFDA and IIROC (see MFDA Rule 1.2.5 and 2014 IIROC Guidance Note on Use of Business Titles and Financial Designations).

Closing Remarks

The PCMA would like to thank to the CSA for their efforts in drafting the Proposal and for soliciting feedback from various stakeholders.

*   *   *   *

We thank you for considering our submissions and we would be pleased to respond to any questions or meet with you to discuss our comments.

Yours truly,

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