

MEMO# 31313

August 2, 2018

Canadian Securities Administrators Published Request for Comment on Client Focused Reforms and Status Report on Embedded Commissions

[31313]

August 2, 2018 TO: ICI Members

ICI Global Members

ICI Global Regulated Funds Committee

SEC Rules Committee SUBJECTS: International/Global RE: Canadian Securities

Administrators Published Request for Comment on Client Focused Reforms and Status
Report on Embedded Commissions

On June 21, 2018, the Canadian Securities Administrators (CSA) published two notices concerning investor protection initiatives, (1) a notice and request for comment regarding reforms to enhance the client registrant relationship (Client Focused Reforms)[\[1\]](#) and (2) a status report on an earlier consultation on mutual fund embedded commissions and the CSA's proposed next steps (Embedded Commissions Report).[\[2\]](#)

Comments on the proposed Client Focused Reforms are due by October 19, 2018. We are reviewing these documents and considering whether to submit a response to the Client Focused Reforms consultation.

Client Focused Reforms Proposal

In the Client Focused Reforms notice, the CSA proposes amendments to National Instrument 31-103 (the Rule) and Companion Policy 31-103CP (the Policy) which cover registration requirements, exemptions and ongoing registrant obligations. The proposed changes are intended 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 clear to clients the nature and terms of their relationship with registrants. Specifically, the proposed changes would require registrants 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 CSA is not proposing to adopt an overarching regulatory best interest standard at this

time, as was proposed in an earlier consultation.

The following sections of the Rule are proposed to be amended and supported by detailed guidance:

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

Of particular relevance and potential concern to the regulated fund industry, the proposed amendments relating to conflicts of interest and suitability would require registrants 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. Additionally, the enhancements to the suitability determination requirement would include explicitly requiring registrants to consider certain factors, including costs and their impact.

The CSA states that they believe the proposed amendments relating to conflicts of interest will allow registrants flexibility in how they address the material conflicts of interest presented by mutual fund embedded commissions in a manner that is in the best interest of clients.

Mutual Fund Embedded Commissions Report

In January 2017, the CSA issued Consultation Paper 81-408 seeking feedback on the option of discontinuing embedded commissions.[\[3\]](#) In the Embedded Commissions Report the CSA provides a summary of the earlier consultation process and the feedback received, and announces its policy decisions on mutual fund embedded commissions. The CSA is proposing to implement the following three policy changes:

- to implement enhanced conflict of interest mitigation rules and guidance for dealers and representatives requiring that all existing and reasonably foreseeable conflicts of interest, including conflicts arising from the payment of embedded commissions, either be addressed in the best interests of clients, or avoided (see Client Focused Reforms);
- to prohibit all forms of the deferred sales charge option, including low-load options and their associated upfront commissions in respect of the purchase of securities of a prospectus qualified mutual fund; and
- to prohibit the payment of trailing commissions to, and the solicitation and acceptance of trailing commissions by, dealers who do not make a suitability determination in connection with the distribution of prospectus qualified mutual fund securities.

The CSA expects to publish a notice and request for comment on this matter in September of this year.

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endnotes

[1] http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20180621_31-103_client-focused-reforms.htm.

[2] http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180621_81-330-status-report.htm.

[3] ICI Global submitted a comment letter on the consultation, available at <https://www.iciglobal.org/pdf/30742a.pdf>.

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