

CAC Member Report to Local Board October 29, 2018

The CAC met in-person in Calgary on October 19th, 2018.

In October the CAC shifted our focus away from Derivatives Registration and Conduct and towards investor protection and disclosures.

The Client Focused Reforms (NI-31-103) and Mutual Fund Sales practices (NI 85-105) will significantly impact the sales practices of dealers. More stringent know your product and suitability requirements are proposed along with a meaningful change in the compensation structure of the mutual fund industry. Deferred sales charges will be banned, but trailing commissions that meet an enhanced suitability requirement are allowed. The key controversy for the council is do the proposed reforms go far enough to promote investor protection? Our previous letters supported an O.S.C. lead proposal calling for an outright ban on embedded commissions and the application of a best interest standard.

A second priority of the CAC is a collaborative effort with CFAI and CFA Societies Canada advocating for enhanced disclosures of non-gaap accounting metrics (e.g. EBITDA, ARPU etc.). The key issue in this proposal is promoting the relevance of audited financial statements in securities analysis. A coordinated effort to engage the Accounting Standards Board ought to be considered.

Since the September report, the CAC provided comments on the following consultations (all letters can be seen on the CAC website, www.cfaadvocacy.ca)

- ASC Proposed Revocation of ASC Blanket Order 31-505 *Registration Exemption for Trades in Connection with Certain Prospectus-Exempt Distributions* (filed September 17, 2018)

About the notice

Since NI 31-103 came into force in 2009, several jurisdictions, including Alberta provided a registration exemption under certain prospectus exemptions, including the accredited investor and offering memorandum exemption. This is known as the “Northwestern Exemption”. The ASC is proposing to revoke the exemption, on the basis that it has had little impact on capital raising in the province, and there has been wide spread non-compliance with the terms of the exemption when it has been used. Other provinces are looking to follow suit.

Overview of the Council's comments

We did not see a compelling rationale to maintain the Northwestern Exemption. The Canadian Securities Administrators are working to enhance the client – advisor relationship through additional regulation and given the heightened regulatory expectations of registrants set out in these proposals, it would be incongruent to continue to allow intermediaries to rely on older registration exemptions for transactions, where absent the exemption, clients would receive vastly more protection.

- CSA Notice and Second Request for Comment – Proposed National Instrument 93-101 Derivatives: Business Conduct (filed September 17, 2018)

About the notice

The proposed National Instrument will apply to any person or company who meets the definition of “derivatives adviser” or “derivatives dealer” for OTC derivatives, unless an exemption applies. The instrument takes a two-tiered approach to regulation by tailoring many requirements according to the nature of the party whom the derivatives firm is interacting. Some obligations (e.g., relating to fair dealing, conflicts of interest, segregation of assets and KYC) will apply regardless of the derivatives party’s sophistication or financial resources.

Overview of the Council’s comments

The council was supportive of more harmonized standards for listed derivatives and OTC derivatives, particularly with respect to the reporting and disclosure by derivative parties. While there is room for debate on the scope of the Registration Proposals, we agree that all derivatives advisers and dealers should be subject to minimum standards, even if their activity does not trip the business trigger for registration. Among other recommendations, the council believes the CSA should consider specifying exemption from the adviser registration for portfolio managers utilizing OTC derivatives occasionally or for currency hedging in their managed investment funds/segregated portfolios. Registrants who meet their obligations under NI 31-103 may struggle with the Business Conduct Proposals without targeted, specific information around the additional policies and procedures expected of them under the new regime for OTC derivatives. Given the complexity and magnitude of these regulations, the council suggested that registrants would benefit from additional tools and explanations, by way of guidance notices, registrant outreach, staff notices or otherwise, to help meet their new obligations.

- IIROC Proposed Provisions Respecting Client Identifiers (filed September 26, 2018)

About the notice

IIROC is proposing to amend UMIR and Dealer Member Rules to require client identifiers on each order sent to a marketplace and each reportable trade in a debt security. Currently, multiple identifiers are being used for the same client across different platforms. The identifier would take the form of a Legal Entity Identifier (LEI) or, for clients not eligible for an LEI, their account number.

Overview of the Council’s comments

The CAC supports IIROC’s and the underlying theme behind this global initiative as it believes companies should be required to maintain and report the LEI. In short, this would increase investors’ and IIROC’s ability to identify and analyze the risks of registrants and their subsidiaries. Lastly, the CAC urged IIROC to prioritize the importance of protecting client privacy and ensuring implementation costs are not unduly burdensome on registrants.

- IIROC Proposed Provisions Respecting Order Execution Only Service Eligibility and Adviser Identifiers (filed September 26, 2018)

About the notice

The proposed amendments would prohibit a dealer from providing order execution only services (OES) to another registered dealer (or a person exempt from registration). By way of background, an OES allows a dealer to trade on behalf of a client without a suitability determination. The purpose of the change is to ensure registered dealers use an appropriate channel to access marketplaces and can't access marketplaces when conducting dealing activity. It is intended to avoid a regulatory arbitrage and to assist with surveillance over advisers and better address the risks of electronic trading, the amendments require order execution only dealers to assign identifiers to certain entities, including persons registered or exempt from registration as an adviser or a foreign adviser equivalent that has been granted trading authority.

Overview of the Council's comments

We are strongly supportive of the intended purpose of the proposed amendments, as they would prohibit a dealer from providing order execution only services (OES) to another registered dealer. In addition, to support market surveillance and to better address risks of electronic trading, we expressed support for the amendments that require order execution dealers to assign identifier to entities exempt from registration.

- GFIN Consultation Document (filed October 11, 2018)

About the notice

The Global Financial Innovation Network (GFIN) has published a consultation paper with respect to the potential collaboration of various regulators on emerging innovation trends in financial services, such as big data, AI and blockchain applications. The proposal suggests GFIN would act as a network of regulators to share experiences and best practices, provide a forum for joint policy work, and allow firms to conduct cross border trials. The desired outcome of the initiative is a global system that better serves society by harnessing technology to provide improved service and create a new framework for cooperation between financial service regulators to complement the work of other standard setting organizations. Comments are sought on its mission statement, functions and priorities.

Overview of the Council's comments

The council fundamentally agreed with the global approach taken by regulators to FinTech. The suggested framework is sufficiently flexible to allow for new technologies and transactions, including for example in the context of digital currency. This will bring legitimacy, attract investors and promote economic activity. The council urged the importance of enforcement in the current framework and suggested that it should be a priority, while permitting potential exemptions when the framework is unable to accommodate the technology. Overall, the council suggests the importance for regulatory transparency with respect to requests for exemptions received and policy options to ensure a long term approach is taken to land on a consolidated approach, with a level playing field

- CSA Proposed Amendments to NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (filed October 18, 2018)

About the notice

Fresh off the best interest consultation, The CSA's amendments to NI 31-103 add new requirements and represent a fundamental shift in the adviser/client relationship. One of the largest impact is on the suitability determination, where registrants would be required to explicitly consider the best interest of the client in their suitability decisions. The provisions on conflicts has been expanded to include all reasonably foreseeable conflicts, not just material conflicts. All conflicts would have to be resolved in the best interest of the client. Certain conflicts are identified, including proprietary products, referral arrangements, and conflicts in fee-based accounts. New rules are also proposed with respect to misleading marketing and use of titles. Other amendments include those relating to referral agreements and referral payments.

Overview of the Council's comments

The council expressed disappointment with the CSA's decision to move away from the principled based best interest standards. The council believes that while the new 'targeted' or rules-based approach is directed to *all* registrants, some registrants currently operate under the elevated best interest framework. In the absence of the principled based best interest standard, the council generally supports the harmonized approach and added specific and thoughtful comments to help regulators. An overarching theme of the comments however, focused on requesting regulators to aim towards lessening the rules-based regulatory and cost burdens. Moreover, the council suggested providing specific and targeted guidance to the industry on the additional KYC and KYP requirements.

The CAC is actively working on a response to the following consultations:

- CSA Proposed Amendments to NI 81-105 Mutual Fund Sales Practices and Related Consequential Amendments (due December 13, 2018)

About the notice

The proposed amendments would prohibit, in connection with the distribution of prospectus qualified mutual fund securities: (i) the payment of upfront sales commissions by fund organizations to dealers (thereby discontinuing DSCs) and (ii) trailing commission payments by fund organizations to dealers who do not make a suitability determination. The CSA expects that since fund organizations will not incur the cost of financing upfront sales commissions, the management fees charged to the funds who previously offered a DSC option will be reduced, and that dealers will turn to their clients for direct compensation. The CSA expect to provide a transition period of one year from the date of final publication of the amendments. These amendments will complement the Client Focused Reforms already proposed as amendments to NI 31-103.

- AMF Regulation respecting Alternative Distribution Methods (due December 10, 2018)

About the notice

The proposed regulation relates to the distribution of insurance products (and financial planning products) without an intermediary, primarily through the Internet. The proposed framework is based on disclosure to clients, and requirements are proposed with respect to the platform and the training and supervision of distributors. Through the platforms,

distributing firms must inquire into their clients' needs and if applicable, ensure the products they are offering are suitable. The AMF is of the view that comparison shopping sites that direct clients to other websites to enroll in an insurance contract must also be registered and comply with the draft regulation if they receive payment for products sold. Certain prescribed information would have to be included on the platform, and clients would need to be provided with specified summary information about the applicable product.

- CSA Proposed NI 52-112 Non-GAAP and Other Financial Measures Disclosure (due December 5, 2018)

About the notice

The proposal and its Companion Policy sets out requirements for the use of non-GAAP financial measures (such as “adjusted EBITDA”) and other financial measures (such as the newly defined terms of segment measures. While the rules would not contain specific limitations or industry-specific requirements, they will establish disclosure requirements that must be met in order to use non-GAAP and other financial measures and help investors appreciate the context of such measures. The proposed rules replace (and are substantially aligned with) existing CSA guidance on the use of such measures, which may lack standardized meaning, context, transparency or vary significantly by issuer. Disclosure rules would include certain labelling and prominence requirements, as well as certain reconciliation requirements.

At the in-person meeting in Calgary, the CAC met with representatives of the following organizations:

- DLA Piper: Jarrod Isfeld, Partner - Securities Lawyer
- Alberta Securities Commission: Lara Gaede, CFA, Chief Accountant and CFO and Lynn Tsutsumi, Director, Market Regulation
- GENn Family Office: Jared Wolk, CFA, CIO

General Affairs:

The CAC is still looking to add a few members to its membership base. If you are a dedicated volunteer with strong communication skills and interested in helping shape the future of our capital markets we would like to hear from you! Feel free to contact us for more information at cac@cfacanada.org.

General affairs:

The CAC was mentioned in Investment Executive, read the article [here](#)

Reminder:

All letters can be seen on the CAC website, www.cfaadvocacy.ca

Be sure to [Follow Us on LinkedIn](#) to stay up to date on our activities.

Rob Gouley, CFA
Chair, Canadian Advocacy Council