

## **CAC Member Report to Local Board December 17, 2018**

The CAC met on the phone on December 11th, 2018.

On our last call there were no new proposals to consider. The CAC is awaiting a request for comments from the CSA discussing an equity trading transaction fee pilot (similar to what was proposed by the SEC earlier this year). I expect the trading community to be very engaged on this issue in the new year.

Otherwise, the council commented on three proposals recently. Our comments on Mutual Fund Sales Practices were mainly a reiteration of our prior view. The AMF Alternative Distribution letter focuses on internet comparison shopping websites and suitability analysis. The Non-GAAP Disclosures proposal was an exercise in reconciliation and consensus building. The CAC engaged with many stakeholders who all had slightly different views on Non-GAAP disclosures. I was particularly pleased with the outcome of this engagement and would highlight this letter as an example demonstrating our collaboration and consultation with our stakeholders, standards setters and other industry advocacy groups.

The council is open minded and transparent. We may not agree with all views, but we are always willing to listen and hear a position or an opinion.

**Since the November report, the CAC provided comments on the following consultations (all letters can be seen on the CAC website, [www.cfaadvocacy.ca](http://www.cfaadvocacy.ca))**

- CSA Proposed Amendments to NI 81-105 Mutual Fund Sales Practices and Related Consequential Amendments (filed December 7, 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.

### *Overview of the Council's comments*

The CAC believes simple and transparent fee structures help promote investor protection and strengthen the relationship between the investor and the advisor. Consistent with the council's prior submissions, we expressed disappointment with how the current proposal allows fund organizations to use trailing commission payments, as an incentive, to promote fund sales to investors, so long as the dealer makes a suitability determination. In addition, we requested guidance detailing how an advisor can and should manage conflicts within the potential new enhanced suitability requirements set out in the Client Focused Reforms in the proposed amendments to NI 31-103. Lastly, the

CAC supported the proposal of banning trailing commission payments by fund organizations to dealers who do not make a suitability determination.

- AMF Regulation respecting Alternative Distribution Methods (filed December 7, 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.

*Overview of the Council's comments*

- We expressed support for the proposed Draft Regulation as it relates to the regulation of insurance products (and financial planning products) distributed without an intermediary, primarily through the Internet. We believe building a suitability requirement into the Draft Regulation should be an important component of the proposed framework. The council believes the burden of proof for demonstrating suitability analysis and conflict assessments should fall on the manufacturer or consolidator of the product being sold. In terms of disclosure requirements, we agreed that certain prescribed information should be included on each distribution platform. In particular, clients should be provided with specified summary information about the applicable product being sold. More importantly, the council expressed that the focus should be given to how the process of optimization nudges a client through various steps on a platform – such optimization may come at a cost of unsuitable recommendations. In particular, consumers may not know that they are being “guided” by algorithms as they input information into an on line application form. We recommend that the regulators take a cautious and forward-looking approach to the implementation and future enforcement of the Draft Regulation. It is important to first collect and examine data that can be used in informing regulatory positions. The surplus of data that is readily available to regulators should allow for a thoughtful study of the disintermediated market and client interactions with distributors.
- CSA Proposed NI 52-112 Non-GAAP and Other Financial Measures Disclosure (filed 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.

### Overview of the Council's comments

The CAC expressed strong support for the proposed NI 52-112 and related amendments. In the council's view, the proposal creates a set of enforceable standards that will further meaningful disclosures to investors without unduly limiting the ability of an issuer to tell their own story using what it deems to be the appropriate financial measure. The CAC believes the use of APMs reflect the investors' demand for such measures. However, while most APMs are useful measures, they may lack many of the secondary characteristics of a high-quality performance measure such as consistency, comparability and verifiability. Therefore, the proposed rule will help address such deficiencies by requiring APMs to be more clearly identified, labeled, and reconciled back to GAAP measure.

We also noted that Canadian companies compete in and raise capital in a global market and Canada's regulations should therefore position our issuers to succeed on the global stage. A harmonization of standards across Canada and with international standards is ideal. More importantly, the Council believes investors will benefit from a more transparent, consistent and comparable reporting regime that includes industry specific APM disclosures. However, we cautioned against overly being prescriptive in this approach because excessive disclosure risks overwhelming investors with unnecessary information. In fact, excessive disclosure relating to APMs measures may actually disincentivize issuers from communicating fully with their investors and place less emphasis on written materials that are broadly available to investors. Lastly the CAC stated that formalizing the already existing Staff Notices into a National Instrument should not be overly burdensome to Canadian issuers. Therefore, this process should help regulators establish the necessary enforcement and compliance tools.

### **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](mailto:cac@cfacanada.org).

### **Reminder:**

All letters can be seen on the CAC website, [www.cfaadvocacy.ca](http://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