

CSA Notice of
Amendments to
National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*
and to
Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*
Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

October 3, 2019

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are adopting amendments (the **Amendments**) to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103** or the **Rule**) and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**31-103CP** or the **Companion Policy**, together the **Instrument**).

The Amendments are relevant to all categories of registered dealer and registered adviser, with some application to investment fund managers.

The Amendments have been or are expected to be adopted by each member of the CSA.

The Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association of Canada (**MFDA**) (together, referred to as the **self-regulatory organizations** or **SROs**) have participated in the development of the Amendments. We expect the SROs to amend their respective member rules, policies and guidance to be uniform with the Amendments in all material respects. When that process is complete, corresponding amendments will be made to the exemptions for SRO members in Part 9 of NI 31-103.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Provided all ministerial approvals are obtained, the Amendments will come into force on December 31, 2019. Implementation of the Amendments will be subject to a transition provision discussed below.

Substance and Purpose

The Amendments implement the Client Focused Reforms (**CFRs**) which make changes to the registrant conduct requirements in order to better align the interests of securities advisers, dealers and representatives (**registrants**) with the interests of their clients, improve outcomes for clients, and make clearer to clients the nature and the terms of their relationship with registrants.

The CFRs are based on the concept that in the client-registrant relationship, the interests of the client come first. Under the Amendments, registrants will be required to

- address material 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.

These core elements of the Amendments are supported with the introduction of a know your product (**KYP**) provision in the Rule and enhancements to the existing know your client (**KYC**), suitability, conflict of interest, and relationship disclosure information (**RDI**) requirements. These provisions set out the fundamental obligations of registrants toward their clients and are essential to investor protection. They are designed to work together throughout the client-registrant relationship, as an extension for the duty of registrants to deal fairly, honestly and in good faith with their clients.

The Amendments to the KYC requirements are needed to support the enhanced suitability determination obligations. The new KYP requirements set out firm and registered individual obligations that support the enhanced suitability determination obligation and the enhanced conflicts of interest requirement. Amendments to the conflicts of interest provisions support the new obligation to address conflicts in the client's best interest with requirements for registered firms and registered individuals concerning the identification and disclosure of material conflicts. The Amendments to the RDI requirements include requirements to inform clients about potentially significant restrictions, costs and limitations relating to the products and service offered to them. There are also new provisions concerning misleading communications. Finally, the Amendments include additions to internal controls and a requirement for firms to provide training to their registered individuals. The Amendments also include some technical, non-substantive consistency changes to the Instrument.

Some of the Amendments will impose new requirements, while others codify best practices set out in existing CSA and SRO guidance. We believe that, taken together, they will result in a new, higher standard of conduct across all categories of registered dealer and registered adviser.

Annex A – Summary of changes to the Instrument describes the key changes to the Rule and Companion Policy in more detail.

Background

The CFRs were developed over the course of an extensive consultation process.

Publication for Comment

We published proposed amendments for comment on June 21, 2018 (the **Proposals**). In the Amendments, we have made changes to certain of the Proposals. These changes are summarized below and discussed in Annex A and Annex B – *Summary of comments on the Proposals and responses*. As these changes are not material, we are not publishing the Amendments for another comment period.

Earlier Consultation Process

The Amendments were developed after an extensive consultation process, including CSA Consultation Paper 33-403 *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (2012) and CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* (2016), among other publications, as well as public consultation meetings held in some CSA member jurisdictions.

Further Reforms

We intend to develop and propose for comment additional reforms relating to some of the proposals discussed in the consultations leading up to the Proposals. These are separate, longer-term projects. They may include:

- reviewing proficiency standards;
- imposing a statutory fiduciary duty when a client grants discretionary authority in those jurisdictions which do not currently have this provision;
- clarifying the role of ultimate designated persons and chief compliance officers;
- reviewing titles and designations;
- reviewing referral arrangements;
- revisiting the provision, originally included in the Proposals, relating to publicly available information.

Summary of Written Comments Received by the CSA

During the comment period, we received submissions from 135 commenters. We have considered the comments received and thank all of the commenters for their input. A summary of comments together with our responses is set out in Annex B. The names of commenters are contained in Annex C – *List of commenters*.

Copies of the comment letters were posted on the following websites:

- the Alberta Securities Commission at www.albertasecurities.com
- the Autorité des marchés financiers at www.lautorite.qc.ca
- the Ontario Securities Commission at www.osc.gov.on.ca

Summary of Changes to the Proposals

In developing the Amendments, we carefully reviewed the comments that we received on the Proposals. Public comments make a valuable contribution to the rulemaking process. This includes finding the right balance between achieving regulatory goals and the associated burdens. We found some of the comments recommending changes to be persuasive and revised the Proposals accordingly. We believe we have achieved an appropriate balance, keeping the core elements of the CFRs intact after streamlining the Proposals to remove obstacles to effectively operationalizing them. Ultimately, these measures will help achieve the investor protection goals of the CFRs.

Among the more notable changes, which are summarized below, we have,

- added a materiality qualifier in the conflicts of interest provisions,
- removed prescriptive restrictions on referral arrangements,
- removed the proposed new provision for publicly available information, and
- made changes to parts of the Rule and added guidance in the Companion Policy to help registered firms to scale the CFRs to their particular operations.

In addition to these notable changes, the Amendments also include other changes to the Rule and revisions to the guidance in the Companion Policy, which are primarily intended to clarify the interpretation of the new requirements.

The changes to the Proposals and our reasons for making them are discussed in more detail in Annex B.

Referral arrangements

- We removed the proposed restrictions on referral arrangements and referral fees (existing requirements relating to referral arrangements remain in place and the enhanced standard for conflicts of interest will apply to referral arrangements).

Publicly available information

- We removed the proposed requirement to make certain information publicly available.

Conflicts of Interest

- We added a materiality threshold with respect to conflicts of interest, and guidance to explain when a conflict of interest is “material”.
- We removed the proposed prohibitions on acting as a power of attorney or trustee for clients.

Suitability

- We removed certain proposed suitability assessment factors from the express list in the Rule requirement, addressing them, instead, with guidance in the Companion Policy, including

- the features and associated costs of the account type made available to the client, and
 - the overall concentration and liquidity across all of the client's accounts at the firm.
- We removed the proposal to include “any other factor that is relevant under the circumstances”.
- We expanded the existing exemption for permitted clients so that non-individual permitted clients can waive suitability determinations for managed accounts.
- We removed proposed guidance suggesting that a registrant should inquire about a client's other investments or holdings held elsewhere in order to inform the registrant's suitability determination.
- We also removed the proposed statement in the Companion Policy that “Unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1)”.

KYC

- We removed the proposed Rule requirement to update KYC if the registrant reasonably ought to know of a significant change in the client's information (the requirement will still apply if the registrant becomes aware of a significant change).
- We made the KYC gathering exemption for non-individual permitted clients consistent with the expanded exemption in the suitability provisions.
- We added Companion Policy guidance to clarify how the KYC requirements can apply to registrants' different business models.

KYP

- We added Companion Policy guidance to more fully address the scalability of the KYP requirements, depending on the nature and complexity of the securities involved.
- We removed the following from the proposed Rule changes:
 - the requirement that a registered firm must perform a comparison between the securities it makes available to clients and other similar securities in the market;
 - prescriptive requirements in respect of securities transferred in (instead, we explain in guidance that registrants must take reasonable steps to

understand transferred in securities within a reasonable time after their transfer);

- the requirement that a registered firm must monitor and reassess a security (firms are only required to monitor for significant changes);
- the requirement that registered individuals must take reasonable steps to understand, at a general level, each type of security available to clients, and how those securities compare;
- the requirement that a registered firm must maintain an offering of securities and services that is consistent with how the firm holds itself out (instead, we discuss holding out in the guidance relating to misleading communications);
- the requirement that a registrant must understand the returns of a security (the Companion Policy guidance notes that under the KYP provisions, registrants should understand the *basis* of the security's return, among other factors).

RDI

- We clarified that the required discussion of any limitations on products and services offered to a client is only required to be at a *general* level.
- We expanded the requirement to provide a general description of the products or services a registered firm will offer to clients in order to make it clear that the description must include reference to any restrictions on the client's ability to liquidate or resell a security.
- We removed restrictions on the products offered to a client (such as only offering proprietary products) from the impacts that must be discussed with clients.
- We clarified that the required discussion of impacts of fees and charges on a client's investment returns is only required to be at a *general* level and relates to *potential* impacts.

Transition

We are providing for a phased transition period, with the Amendments relating to conflicts of interest and the associated RDI provisions taking effect on December 31, 2020, and the remaining Amendments taking effect on December 31, 2021. Registrants will have to comply with the applicable Amendments after those dates. There are no grandfathering provisions.

We will establish an implementation committee to provide guidance, respond to questions and otherwise assist registrants to operationalize the Amendments.

We wish to make it clear that it is not our expectation that current registrants would have to update all existing clients' KYC information and reassess the suitability of their investments as of the effective date of the relevant Amendments (December 31, 2021) or immediately after that date. We would expect registrants to continue to schedule reassessments in accordance with current requirements up until then, and to schedule reassessments in accordance with the triggers in the Amendments after that date.

List of Annexes

This notice contains the following annexes:

- *Annex A – Summary of changes to the Instrument*
- *Annex B – Summary of comments on the Proposals and responses*
- *Annex C – List of commenters*
- *Annex D – Adoption of the Amendments*
- *Annex E – Amendments to NI 31-103*
- *Annex E1 – Blackline showing changes to NI 31-103*
- *Annex E2 – Blackline showing changes to 31-103CP*

This notice will also be available on the following websites of CSA jurisdictions:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.fcnc.ca
nssc.novascotia.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca
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