REGULATORY UPDATE

OCTOBER 9, 2019

What you need to know – Overall fewer changes than proposed but some important ones

On October 3, 2019, the Canadian Securities Administrators (CSA) issued its final amendments to National Instrument 31-103 (NI 31-103) *Registration Requirements, Exemptions and Ongoing Registrant Obligations* related to the Client Focused Reforms (CFRs). The final amendments were developed after an extensive consultation process that started in 2012 and included draft amendments to NI 31-103 that were published for comment by the CSA in June 2018 (the Proposals).

These are important rule amendments as they will form the basis of the future regulatory environment for firms and advisors. We commend the regulators for listening to industry participants in bringing forward balanced ideas and removing some of the more contentious proposals.

Overall, there are fewer changes and the changes are much more reasonable than what was contemplated in the Proposals. However, there are still some significant changes from what is required today. We have set out below some of the more important changes that we think firms and advisors should be aware of.

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This event is pending CE credit eligibility for IIROC and The Institute. If approved, we will mail your CE certificate in approximately 6-8 weeks after the event.

Next Steps and Additional Information

- It is important to note that these rules still must pass Ministerial approval and, if approved, would come into force by the end of 2019.
- These rules do not apply right away. There is a phased transition period with the amendments relating to Conflicts of Interest and the associated Relationship Disclosure Information provisions taking effect on December 31, 2020 and the remaining amendments taking effect on December 31, 2021.
- While this stage of the CFRs is now complete, the regulators have indicated that they intend to develop additional reforms as part of separate longer-term projects. These may include reviewing proficiency standards, clarifying the role of the ultimate designated persons and chief compliance officers, reviewing titles and designations and reviewing referral arrangements.
- The full paper is available at http://ow.ly/UePw50wC6DL
- If you would like a more in-depth briefing on these papers or the regulatory landscape in general, please contact your Fidelity representative.

Fidelity INVESTMENTS

Client Focused Reforms

- **No overarching regulatory best-interest standard:** Consistent with the Proposals, the regulators will not move forward with an overarching best-interest standard. Instead, the regulators have adopted a best-interest standard for material conflicts of interest and a “client interest first” standard for suitability.

- **New Conflicts of Interest Requirements:** The regulators have adopted a suite of reforms relating to conflicts of interest with a materiality threshold and guidance to explain when a conflict is “material”. Firms and advisors will be required to identify existing and reasonably foreseeable “material” conflicts between the firm, the advisor and the client. Material conflicts of interest must be addressed in the best interest of the client. We note that the guidance provided on: (i) compensation from third parties (including embedded commissions); (ii) sales practices and incentives; and (iii) the use proprietary products, have largely remained unchanged from the Proposals. In addition, advisors will need to evaluate whether a fee-based compensation arrangement is in the best interests of the client, given the client’s circumstances, investment needs and objectives, and account activity.

- **New Proprietary Product Requirements:** The CFRs indicate that it is almost always a material conflict of interest to sell proprietary products. As a result, any sale of a proprietary product must be in the best interests of the client. The regulators have given fulsome guidance on controls that firms should put in place, including: (i) prohibiting monetary and non-monetary benefits that could bias recommendations to sell proprietary products over third-party products; (ii) prohibiting incentives that create bias; and (iii) making third-party products as easy to access for advisors and clients as proprietary products.

- **New and Expanded Relationship Disclosure Information (RDI)**: The CFRs include a new requirement that RDI include a general description of any limits on the selection of the products or services the registrant will offer to the client, including whether the firm will primarily or exclusively use proprietary products in the client’s account. In addition, the CFR’s expand the RDI fee disclosure requirements to expressly include disclosure of investment fund management expense fees or other ongoing fees the client may incur.

- **Increased Know your Client (KYC) Requirements:** Similar to the Proposals, the CFRs enhance KYC rules by requiring advisors to gather sufficient information about their clients to make a suitability determination. This includes obtaining clients’ personal and financial circumstances (including a breakdown of financial assets), investment needs and objectives, risk profile (comprised of a client’s risk tolerance and risk capacity), investment time horizon and investment knowledge. To satisfy KYC rules, the regulators expect a meaningful interaction between advisors and their clients with KYC information updated at specified intervals, depending on the type of account, and within a reasonable time after becoming aware of a significant change. Advisors must obtain confirmation from clients on the accuracy of their KYC information collected within a reasonable time after receiving the

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information or when the advisor becomes aware of a significant change in the client's information. The KYC obligation is the same irrespective of the medium through which an advisor interacts with its clients.

- **Introduction of Know your Product (KYP) for Firms:** Before offering a product for sale, the regulators expect firms to take reasonable steps to assess the product's structure, features, risks, and costs (including impact of costs) and approve it. The regulators removed the onerous requirement in the Proposals for firms to compare the products they make available to clients with similar products available in the market. Firms will also only need to monitor products for significant changes rather than monitoring and reassessing them based on performance, client outcomes and continued competitiveness. Where a firm offers proprietary products and third-party products, the regulators expect that the proprietary products will be subject to the same KYP requirements and approval processes.

- **Introduction of KYP for Advisors:** The regulators expect that advisors, based on their proficiency, have a general understanding of the types of products available for them to purchase, sell or recommend through their firm. The regulators removed the requirement in the Proposals that advisors take reasonable steps to understand at a general level all products on a firm's shelf and how they compare so that they can select a smaller universe of products to focus on. However, advisors must still take steps to understand the structure, features, risks and costs (including impact of costs) of each product they choose to recommend.

- **Titles and designations:** The regulators say titles cannot be misleading and must be based on proficiency, experience and qualifications. Corporate officer titles can only be used if the firm has appointed the person to the corporate office.

- **Overhaul of Suitability Obligations:** Similar to the requirements outlined in the Proposals, the regulators implemented extensive changes to the suitability obligations. Most importantly, the regulators introduced a new core requirement that registrants put their clients' interests first when making a suitability determination. Enhanced suitability obligations also include: (i) considering certain factors, including costs and their impact on client returns; (ii) moving away from trade-based only suitability to an overall account and portfolio-level suitability; and (iii) reassessing suitability when certain triggering events arise. The suitability criteria apply to all 'investment actions' including, for example, determinations about how much cash to leave uninvested in a client's account. However, the regulators removed the requirement in the Proposals for advisors to automatically consider lower-cost products unless an advisor has a reasonable basis for determining that a higher-cost product will be better for a client.

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- **Removed Changes on Referral Fee Arrangements:** The Proposals contained changes to referral fee arrangements that, among other things, would prohibit a registered firm from paying a referral fee to an individual who is not registered. These restrictions were completely removed in the CFRs, but the regulators provided more guidance on how registrants should address conflicts of interest associated with referral fees. The regulators say that before a registrant refers a client, in exchange for a referral fee to another party, the registrant must determine that making the referral is in the client's best interest. In making that determination the regulators expect registrants to consider the benefits to the client of making the referral over alternatives or at all.
- **Training:** Firms will need to provide training to their advisors on compliance with securities legislation, including on the new and enhanced requirements in respect of KYC, KYP, suitability determinations and conflicts of interest. Firms will have more flexibility in how they implement, maintain and document their compliance training program – depending on the nature, size and complexity of their business.

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