In a Nutshell:
Implementing the Client-Focused Reforms
October 2020

In October 2020, the Canadian Securities Administrators (CSA) finalized their client-focused reforms to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) (CFRs or Amendments). The CFRs are the most sweeping changes to NI 31-103's ongoing registrant obligations since the rule was adopted over ten years ago. These reforms represent a fundamental shift towards a best interest standard.

Implementing the CFRs will require changes to your policies, procedures, internal controls, record-keeping protocols, client-facing documentation and compliance training, but there's no need to panic. AUM Law is here to help. Giving our clients practical advice on compliance with NI 31-103 is one of our core services. We can help you develop a project plan, work with you to systematically review and make any needed changes, and train your employees so that you are ready as the CFRs are phased in.

How We're Helping Clients Implement the CFRs' Conflict of Interest Provisions

We've already started working with clients to implement the CFRs' conflict of interest provisions by the June 30, 2021 deadline, and we can help you, too. Generally, we recommend a five-step process:

1. We guide clients through a process to identify and assess conflicts of interest that exist in their business or involve their staff.
2. Once this conflicts identification and assessment exercise is complete, we guide clients through the process of developing and implementing measures to avoid, manage and/or control each conflict in the best interests of the firm's clients.
3. Steps 1 and 2 result in a conflicts inventory, which the firm's compliance team and management review and update regularly based on discussions and further analysis.
4. We also help clients work their way through a tailored conflicts of interest procedures checklist, so that any changes needed to their operations, compliance manual and procedures, client-facing and other documentation can be made systematically and on a timely basis. The checklist and inventory also enable firms to demonstrate to regulators how they have identified, assessed and addressed in the clients' best interests the conflicts that apply in their business.
5. Finally, we provide tailored training, so that the firm's employees understand the CFRs, the measures the firm is implementing to comply with the new requirements, and what employees' specific responsibilities are.

Your Guide to the CFRs

For your convenience, we have compiled adaptations of our introductory series of articles about the CFRs published in October 2019, November 2019 and January 2020. We have also updated the content to reflect the changes in implementation deadlines announced by the CSA earlier in 2020, as

well as other regulatory developments, and included a link to the CSA's recently published FAQs. To streamline our discussion, we generally refer to NI 31-103 and NI 31-103CP in their current form as the Current Rules and Policy and to the amended versions as the Revised Rules and Policy. The topics are organized as follows:

1. Overview
2. A Closer Look at the Conflict of Interest Provisions
3. A Closer Look at the Know-Your-Client (KYC), Know-Your-Product (KYP), and Suitability Provisions
4. A Closer Look at the Misleading Communications, Relationship Disclosure Information (RDI), Compliance Training and Record-Keeping Provisions
5. CSA Publishes FAQ Guidance on the CFRs
6. Next Steps: How AUM Law Can Help

1. Overview

This overview, adapted from our October 2019 special bulletin, summarizes some of the key differences between the 2018 Proposals and the final CFRs and provides an overview of the updated implementation timeline.

A. Registrants Got Some of the Changes They Wanted

In response to industry feedback, the CSA modified the 2018 Proposals in several key areas:

Conflict of Interest Provisions: A materiality qualifier was added to the new requirement to address conflicts of interest in the best interests of the client, and guidance on that term has been added to the Revised Policy.

Referral Arrangements: The proposed, prescriptive restrictions on referral arrangements and referral fees (including the prohibition on paying referral fees to non-registrants) were dropped. (However, the existing requirements, and the new, enhanced conflicts of interest standard, will apply to referral arrangements.)

Public Disclosures for Prospective Clients: The CSA shelved (for now, at least) its plan to require registrants to make publicly available information that a reasonable investor would consider important in deciding to become a client of the firm.

KYC: The CSA revised the proposed requirement for registrants to update KYC information if they "reasonably ought to know of a significant change." Now, the requirement will be triggered when the registrant "becomes aware" of a significant change. The CSA retained the new, minimum intervals for reviewing clients' KYC information: 12 months for managed accounts, 12 months before making a trade or recommendation for exempt market dealers (EMDs), and 36 months for other cases.

KYP: The CSA narrowed the scope of and clarified the new KYP requirements for registered firms and individuals. For example, the proposed KYP requirement for securities transferred in (legacy securities) was removed, and the application of KYP to client-directed trades was clarified.

Suitability: The 2018 Proposals replaced the principles-based approach to suitability in section 13.3 of NI 31-103 with, among other things, a laundry list of prescribed factors to be considered in determining whether an investment action or recommendation was suitable. The Revised Rules shortened that list and amended the triggers for assessing and reassessing suitability to make them more practicable to apply.

Expanded Waivers for Permitted Clients: The 2018 Proposals did not include any carve-out from the enhanced KYC and suitability requirements for firms that deal with permitted clients who waive those rights in writing. The Final Rules reinstate these carve-outs. In addition, the CFRs will permit advisers to obtain written suitability waivers from permitted clients (other than individuals) in respect of managed accounts.

Deferred Sales Charge (DSC) Options: On February 20, 2020, CSA members except the OSC (Participating Jurisdictions) announced amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (NI 81-105) and related instruments to prohibit DSCs for investment funds. The amendments will take effect on June 1, 2022. At the same time, the OSC proposed a rule that will restrict the availability of the DSC option in Ontario. Regulators in the Participating Jurisdictions indicated that, pending the effective date of these amendments, they will exempt dealers from application of the conflict of interest rules in the CFRs as they apply to the DSC option, provided that dealers comply with the rules currently in effect in NI 31-103. In the notice accompanying its proposed rule on the DSC option, the OSC stated that it considers it a conflict of interest for registrants to accept upfront commissions associated with the sale of securities under a DSC option. Therefore, it expects registrants to address that conflict consistent with their obligations under NI 31-103, in its current state, and as amended by the CFRs, when those amendments take effect on June 30, 2021.

B. Get Ready to Revise Your RDI

The Revised Rules will require some changes to RDI. We've highlighted two key requirements below.

Restricted Offerings: The Revised Rules will extend the existing requirement to describe products and services so that registered firms will have to disclose any restrictions, including whether the firm primarily or exclusively offers proprietary products to clients. The CSA considered but rejected submissions to drop this requirement. They did, however, remove the proposed requirement to discuss the impact of restricted offerings, including proprietary products.

Costs and Fees: The Revised Rules kept, with only minor changes, the new requirement for registered firms to explain the impact of charges and fees on a client's investment returns. The requirement has been revised so that it only requires a "general" explanation of "potential" impacts.

C. Scalability

The CSA embraced "scalability" as a mechanism to address various comments that either: (1) asked for carve-outs from the rules for certain business models or situations; or (2) criticized the proposed amendments as too prescriptive. For example:

- EMDs, portfolio managers (PMs), and scholarship plan dealers (SPDs) did not get their requested exemption from the CFRs.
- Guidance has been incorporated into the Revised Policy about how the KYC, KYP and suitability requirements can be scaled to fit a firm's business model, the types of securities it offers, the nature of its relationships with clients, and the specific circumstances regarding a particular transaction or recommendation.
- The CSA revised its proposed guidance on registered firms' obligations to provide KYP-related compliance training so that the Revised Policy: (1) recognizes that the scope of a firm's compliance training programme will depend on the nature, size and complexity of its business; and (2) gives firms more flexibility in how they implement, maintain and document their training programs.

D. Implementation Timeline

The Revised Rules came into force in December 2019, but implementation is being phased in.

- **Conflicts-related rule changes** take effect on June 30, 2021.
- **The remaining amendments** will take effect on December 31, 2021.

The CSA clarified that it does not expect current registrants to have to update all their existing clients' KYC information or reassess the suitability for their investment as of the effective date of the relevant amendments or immediately after that date. Rather, the CSA expects registrants to continue scheduling reassessments according to current requirements until the effective date and then to reschedule reassessment according to the triggers in the CFRs after that date.

2. A Closer Look at the Conflict of Interest Provisions

In this section, we highlight the conflict of interest provisions, including the provisions relating to referral arrangements and borrowing from clients. All of these rules are scheduled to take effect on June 30, 2021.

A. Overview

Section 13.4 of the Revised Rules sets out registered firms' obligations to identify, address and disclose material conflicts of interest. New section 13.4.1 introduces parallel requirements for registered individuals. Significant elements in the revised conflicts regime include the following:

Identify Material Conflicts: Under the Revised Rules, registered firms must take reasonable steps to identify existing and reasonably foreseeable, material conflicts of interest between:

- The firm and the client; and
- Each individual acting on the firm's behalf and the client.

New subsection 13.4.1(1) requires registered individuals to identify existing and reasonably foreseeable, material conflicts between themselves and their clients.

Expanded Definition of Conflict of Interest: According to the Current Policy, a conflict exists if the interests of different parties (such as the client and registrant) are inconsistent or divergent. The Revised Policy keeps that concept and adds that a conflict also exists where:

- A registrant may be influenced to put their interests ahead of their client's interests; or
- Monetary or non-monetary benefits available to the registrant, or potential detriments to which a registrant may be subject, may compromise the trust that a reasonable client has in the registrant.

Address Material Conflicts in Client's Best Interest: The Current Rules require registered firms to "respond" to material conflicts. Under the Revised Rules, registered firms and individuals must address material conflicts in the client's best interest and avoid any material conflict that is not, or cannot be, addressed in the client's best interest.

In the notice accompanying the Revised Rules and Policy (Notice), the CSA reiterated that the CFRs **do not** impose on registrants a fiduciary duty as a regulatory standard of conduct. Many commenters on the proposed CFRs had asked the CSA to clarify the difference between the fiduciary and best interest standards. The CSA did not, and probably could not, provide a clear, one-size-fits-all answer. It will take time, and the application of the best interest standard to specific fact situations, for a clearer picture of the CSA's interpretation of this standard to emerge.

In the meantime, the CSA emphasized in the Notice that the standard means that registered firms and individuals must put the client's interests first, ahead of their own interests and competing considerations. Although this is a very high standard, we interpret the CSA's commentary to mean that registered firms and individuals do not have to negate their own interests, just subordinate them. As well, there can be more than one way to act in a client's best interest.

Disclosure Is Required But It Isn't Enough: The Revised Rules expressly state that providing disclosure to the client does not, in itself, satisfy a registered firm's or registered individual's obligation to address material conflicts of interest in the client's best interest. (We discuss disclosure requirements in more detail in Section B below.)

General Test for Determining Materiality: The Revised Policy includes a general test for determining materiality. Registrants should consider whether the conflict may be reasonably expected to affect, in the circumstances, the client's decisions and/or the registrant's recommendations or decisions.

Expanded Guidance on Conflicts: In the Revised Policy, the CSA lists situations that it considers to be inherent conflicts of interest that are almost always material:

Inherent, "Almost Always" Material Conflicts

- Trading in or recommending proprietary products
- Receiving compensation from a third party
- Paid referral arrangements
- Client is in a fee-based account that holds securities with embedded commissions
- Registrant has full control or authority over an individual client's financial affairs or acts as an executor for a client's estate
- Certain internal compensation practices and arrangements:
  - Registered firms creating incentives to sell or recommend certain products or services over others
  - Registered individuals receiving greater compensation from their firm for the sale or recommendation of certain products or services over others
  - Sales and revenue targets for registered individuals
  - Compliance or supervisory staff compensation tied to sales or revenue of the firm overall or the registered individuals they supervise

Potentially Material Conflicts: The Revised Policy also discusses other types of potential conflicts. Some of this discussion is substantially similar to the Current Policy and some of it is revised or new. Some examples of the new guidance are set out below:

- Purchasing assets from a client outside the normal course of a registrant's business may create a material conflict of interest.
- Before a registered individual joins a registered firm, the firm should require that individual to disclose all outside business activities (OBAs) and should review and approve such OBAs.
- When a registered individual acts as a director, officer, shareholder, owner or partner of an issuer whose securities the registered individual also recommends to clients, conflicts of interest are exacerbated. The firm and the registered individual have heightened responsibilities to address the conflict due to the severity of the risk to the client.

Controls to Address Material Conflicts: The Revised Policy also includes extensive guidance on controls that registered firms should consider to address material conflicts. It includes a new section on general control measures (tone at the top, anyone?) as well as detailed guidance on potential control measures for specific types of conflicts. Of particular interest are the suggested controls for registered firms that only trade in or recommend **proprietary products** such as:

- Documenting how such products fit within the firm's business model and strategy and how they are aligned with clients' interests;
- Conducting periodic due diligence on comparable, non-proprietary products and evaluating whether the firm's proprietary products are competitive with available alternatives; and
- Obtaining independent advice on, or an independent evaluation of, the effectiveness of the firm's policies, procedures and controls to address this conflict.

Registered Individuals to Report Material Conflicts to Their Firm and Wait for Consent: A registered individual who identifies an existing or reasonably foreseeable, material conflict of interest between themselves and a client:

- Will have to promptly report that conflict to their sponsoring firm; and
- Must not engage in any trading or advising activity in connection with that conflict unless the conflict has been addressed in the client's best interest and the sponsoring firm has consented to proceeding with the transaction.

The Revised Policy provides guidance on how firms can provide consent. For example, if the registered individual acts in accordance with the firm's policies and procedures relating to the conflict in question, that may be sufficient consent unless the firm chooses to require its representatives to obtain express consent before proceeding with the activity.

Interaction of Registered Individuals' and Firms' Obligations: The Revised Policy doesn't discuss in detail how registered individuals' obligations to identify, report and address material conflicts between themselves and clients interact with the firm's related obligations. In many cases, we expect that firms will prepare lists of material conflicts that affect the whole firm, as well as material conflicts for particular business lines. Registered individuals, in turn, will review those lists and report to their firm any material conflicts involving them that do not appear on the firm's list.

We also believe that registered individuals will have to consider whether firm-identified and self-identified, material conflicts are being effectively addressed at their individual level. As the Revised Policy emphasizes, registered individuals and their sponsoring firms each have a distinct obligation to address material conflicts in the client's best interest. For example, what if a firm puts in place measures intended to address material conflicts arising from its compensation practices but a registered individual believes that these practices still influence them, despite the controls, to put their interests ahead of the client? In such a situation, we think the registered individual would have to avoid that conflict until they could raise their concerns with the sponsoring firm so that a solution could be implemented.

Training: New subsection 11.1(2) of the Revised Rules requires registered firms to train their registered individuals on compliance with securities legislation, including, among other things, the conflict of interest requirements for firms and registered individuals.

Recordkeeping: New subsection 11.5(2)(p) of the Revised Rules requires firms to maintain records that demonstrate compliance with the conflict of interest provisions in Part 13, Division 2. The Revised

Policy states that as the materiality of a conflict increases, there should be greater detail in the records maintained to demonstrate compliance.

Carve-outs: Sections 13.4 and 13.4.1 do not apply to investment fund managers in respect of funds that are subject to National Instrument 81-107 *Independent Review Committee for Investment Funds*.

B. Conflicts of Interest Disclosure

The disclosure requirements for material conflicts of interest have been revised and more extensive guidance has been provided about the timing and content of such disclosures. Key features of the new disclosure regime include the following:

<table>
<tr><td>Trigger: Material conflicts must be disclosed to a client whose interests are affected if a reasonable investor would expect to be informed of such conflicts. (This is similar to the Current Rules.)</td><td>Write It Down: The Revised Rules expressly require written disclosure.</td></tr>
<tr><td>Disclose What? The Current Rules require firms to disclose the nature and extent of conflicts. Subsections 13.4(4)-(6) convert some of the existing guidance into rules and add new elements. The Revised Rules require disclosure of:
The extent and nature of the conflict (carried over from the Current Rules);
The potential impact on and risk that the conflict could pose to the client; and
How the conflict has been or will be addressed.</td><td rowspan="2">Timing
The Revised Rules require disclosure before account opening, if the conflict has been identified at that time. Otherwise, the disclosure must be made in a timely manner.
The Revised Policy notes that although subsection 13.4(7) of the Revised Rules doesn't require firms to remind clients of conflicts disclosure previously provided to them, registrants should consider their obligation to deal fairly, honestly and in good faith with clients in the case of a transaction that presents a conflict that was disclosed a "long time ago."
The Revised Policy reminds registered firms that if there is a significant change in respect of conflicts disclosure previously provided to the client, the relationship disclosure requirements in subsection 14.2(4) of the Revised Rules require the firm to notify the client of the significant change.</td></tr>
<tr><td>Make It Systematic: The Revised Policy states that as part of a registered firm's practices to address material conflicts, they could consider having a system for confirming that effective disclosure of material conflicts is provided to clients. Despite the surprisingly soft language (i.e. "could consider"), we believe that regulatory staff will expect firms to have systems that are appropriate to their business model and scope of operations and reasonably designed to ensure this outcome.</td></tr>
</table>

Nobody Should Put Conflicts Disclosure in a Corner: Like Patrick Swayze, the CSA wants conflicts disclosure to take centre stage. Like the Current Policy, the Revised Policy indicates that disclosure should not be generic, partial or misleading, and should not obscure the conflicts in overly detailed disclosure. The Revised Policy goes even further, stating that firms should consider using a **standalone, succinct conflicts disclosure document.**	**Presentation:** The Revised Rules expressly require the disclosure to be presented in a manner that, to a **reasonable person**, is prominent, specific and written in plain language. This is different from the disclosure trigger, which uses a **"reasonable investor"** test. We think this means that a firm can take its client base into account in deciding whether a material conflict must be disclosed to a particular client. Once the firm concludes that disclosure must be made, however, the disclosure must be presented in a manner that any reasonable person (including an unsophisticated investor) would find prominent, specific and written in plain language.

C. Referral Agreements

Referral arrangements fall within the scope of the general conflict of interest provisions in the Revised Rule and also are addressed in several, standalone provisions in the Revised Rules and Policy.

The definition of "referral fee" has been broadened in the Revised Rules to encompass any "benefit provided" for the referral of a client to or from a registrant. (By contrast, the Current Rules use the term "compensation … paid" for a client referral.)

In addition to classifying referral arrangements as "inherent conflicts" that are almost always material, the Revised Policy provides more extensive guidance on how referral arrangements should be handled. Among other things:

- **No Reliance on Referring Party:** A registrant cannot rely on the referring party to discharge any of the registrant's obligations to the client, including KYC, KYP and suitability determinations.
- **Watch out for Registrable Activities:** Registrants must not knowingly participate in a referral arrangement where the other party is engaged in a registrable activity without being appropriately registered or exempt from registration.
- **Sponsoring Firm to Be Kept in the Loop:** Registered individuals must not enter into referral arrangements independently of their sponsoring firms or without their knowledge.
- **Recordkeeping:** Records relating to referral arrangements should include the name of each client referred, the amount of the fee, the person or company paying the fee, and who provides the disclosure to the referred client.
- **Due Diligence on Recipients of Referrals:** Although section 13.9 of the Current Rule has not been amended, the Revised Policy indicates that the CSA expects registered firms to take certain steps, at a minimum, to conduct due diligence on persons to whom they may refer clients. In particular, they should assess:
  - Which types of clients the referred services would be appropriate for; and
  - The referral party's qualifications, including taking reasonable steps to determine whether the referral party has been the subject of any civil actions, regulatory or professional disciplinary

matters conducted under any legislation, or client complaints, relating to the referral party's professional activities.

D. Restrictions on Borrowing from or Lending to Clients

New subsection 13.12(2) of the Revised Rules introduces a conflict of interest rule into a section of NI 31-103 that previously focused on limiting registered firms' financial exposure to clients. In the Revised Rule:

- Subsection 13.12(1) prohibits registrants from lending money, extending credit or providing margin to a client unless certain criteria are met. (This provision is similar to section 13.12 of the Current Rules, with some additional exceptions from the prohibition added.)
- New subsection 13.12(2) prohibits a registered individual from borrowing money, securities or other assets or accepting a guarantee in relation to borrowed money, securities or other assets from a client unless:
  - The client is a financial institution whose business includes lending money to the public and the loan is made in the normal course of the financial institution's business; and/or
  - Both the following apply:
    - The client and registered individual are related to each other, as provided for in the Income Tax Act (Canada); and
    - The registered individual has their sponsoring firm's written approval to borrow the money, securities or other assets or accept the guarantee.

3. A Closer Look at the KYC, KYP and Suitability Provisions

Crack open the CSA's Revised Rule and Policy, and you'll see a lot of blacklined text in the KYC, KYP and suitability sections. But fear not. Many of the changes in the rules and guidance reflect a codification of good industry practice and/or pre-existing regulatory expectations. For registrants, this means that you might not have to change as many practices as you think you do. You should expect, however, to have to update aspects of your policies, client-facing documentation, books and records, and training. Below, we draw your attention to some changes in the regulatory framework that we think might have an impact on registrants' operations.

A. KYC Requirements

Section 13.2 of the Revised Rules will require registrants to take reasonable steps, among other things, to establish their clients' identity and ensure that they have sufficient information to make the suitability determination prescribed by section 13.3 of NI 31-103 or by the rules of a self-regulatory organization (SRO).

Establishing identity of individuals: The Revised Policy includes more guidance on the meaning of "reasonable steps" to establish an individual's identity, including steps to confirm the accuracy of information to form a reasonable belief about an individual's identity.

Information to be collected: The Revised Rules are more prescriptive about the information to be collected to support the registrant's suitability determination, but for the most part these new rules codify good practices that many market participants have already been following.

- Currently, registrants must collect information about a client's financial circumstances, investment needs and objectives, and risk tolerance.

- When the CFRs come into effect, registrants also will need to collect information about a client's personal circumstances, investment knowledge, and investment time horizon. In addition, "risk tolerance" in the Current Rule is replaced with "risk profile". The Revised Policy explains that "risk profile" encompasses risk tolerance (willingness to accept risk) and risk capacity (ability to endure loss). Many registered individuals probably are already taking the new factors mentioned in this paragraph into account in their suitability determinations. It will be important, however, for the related documentation (*e.g.* KYC questionnaires and registrants' written analyses) to explicitly address these items.

Client to confirm the collected information: New subsection 13.2(3.1) will require the registrant to take reasonable steps to have the client confirm the accuracy of the information within a reasonable time after the registrant collected it.

Tailored KYC process: The Revised Policy emphasizes that registrants should tailor their KYC process to reflect their business model, their relationships with clients, and the securities and services that they offer to them. By way of example, the Revised Policy states that if the securities being sold are illiquid or highly risky, more information on a client's financial circumstances, including investments held elsewhere, might need to be gathered to support a suitability determination. We believe that the regulators are more likely to consider exempt market securities as "illiquid or highly risky". And so, we think that registrants who deal in or advise on exempt market securities may find that they're expected to collect information about their clients' investments held elsewhere, whenever practicable, unless there are clear and well-documented reasons not to do so.

Keeping KYC information current: Subsection 13.2(4) currently requires registrants to take reasonable steps to keep the client's KYC information current. Revised subsection 13.2(4) elaborates on this requirement by stating that it includes updating the client's KYC information within a reasonable time after the registrant becomes aware of any significant change in the client's KYC information. The Revised Policy indicates that updates should be based on "meaningful and documented interaction" with the client.

New subsection 13.2(4.1) sets minimum intervals for reviewing clients' KYC information. For example, even if there has been no triggering event for a KYC review pursuant to subsection 13.2(4), new subsection 13.2(4.1) will require a registrant to review a client's KYC information:

- For managed accounts, at least every 12 months;
- If the registrant is an exempt market dealer, within 12 months before making a trade for or recommending a trade to a client; and
- In any other case, at least every 36 months.

Since many market participants are already performing annual KYC updates, subsection 13.2(4.1) should have little impact on their practices.

B. KYP Requirements

KYP has been an implicit component of registrants' obligations to conduct a suitability determination. The Revised Rules will make KYP an explicit requirement for registered firms and individuals. In summary, new subsection 13.2.1(1) requires each registered firm to:

- Assess the securities it offers to clients, including the securities' structure, features, risks, initial and ongoing costs, and the impact of those costs (Attributes);
- Approve the securities to be made available to clients; and

- Monitor the securities for significant changes.

The Revised Policy includes detailed guidance on these requirements, while noting that the steps taken may vary depending on, for example, a particular security's complexity and risk, the firm's business model, and the nature of its relationship with clients. Although many registered firms probably already carry out these functions, they will need to ensure that they have adequate KYP documentation, processes and controls.

Registered individuals will also have KYP requirements. In particular, a registered individual will not be permitted to purchase or sell securities for, or recommend securities to, a client unless:

- The firm has approved the securities to be made available to clients; and
- The registered individual takes reasonable steps to understand the securities, including their Attributes, to a sufficient degree to enable the registered individual to make a suitability determination.

The Revised Policy expresses the expectation that registered firms will provide registered individuals with access to information that the firm has gathered about the securities, as well as training and tools to help these individuals comply with their KYP obligations. The Revised Policy also indicates that registered individuals should have at least a general understanding of all the types of securities available through the firm, so that they can meet their suitability obligation relating to consideration of a range of alternatives for their clients.

C. Suitability

The suitability determination requirement in section 13.3 of NI 31-103 has been expanded and made more prescriptive.

Potential "investment action" triggers suitability determination: Under revised subsection 13.3(1), a registrant will have to make a suitability determination before most "investment actions". According to the Revised Rule and Policy, this term includes:

- Opening an account for a client;
- Purchasing, selling, depositing, exchanging or transferring securities for a client account;
- Recommending or deciding to continue to hold securities for a client following a review of the client's account; or
- Making a recommendation or decision to take any such action.

What is a suitability determination? Section 13.3 sets out in more detail the factors that must be considered in making a suitability determination. These include, among other things, the client's KYC information, the registrant's KYP assessment of the security, the impact of the investment action on the client's account (including concentration and liquidity factors), the potential and actual impact of costs on the client's return on investment, and a reasonable range of alternative actions available to the registrant through the registered firm (when the determination is made). In addition, the proposed investment action must "put the client's interest first." The Revised Policy includes extensive guidance on what it means to put the client's interests first, including how this concept interacts with suitability determinations with respect to account type, how far a registrant is expected to go in assessing a reasonable range of alternative actions, and the need to take a portfolio approach to suitability. We expect that market participants will have questions for the regulators about what "put the client's interests first" and "assess a reasonable range of alternative actions" mean in practice. As the countdown clock to implementation runs down, and registered

firms start developing procedures to address real-world scenarios, we think this could be an important subject for dialogue with the regulators.

Periodic reviews: Subsection 13.3(2) of the Revised Rule will require every registrant to review each client's account and the securities in it against the suitability criteria within a reasonable time after certain events occur. These events include situations such as the registrant becoming aware of a change in a security in the client's account or a change in the client's KYC information that could result in the security not satisfying the suitability criteria. The mandatory, periodic review of a client's KYC information also triggers this obligation to re-assess suitability.

D. Carve-outs and Waivers

Investment fund managers (IFMs) will not be subject to the KYC, KYP and suitability requirements in respect of their activities as IFMs.

Order-execution only dealers will be exempt from the requirements to collect and keep KYC information current for purposes of the suitability determination, from the KYP requirements, and from the suitability determination requirement itself.

Waivers: Registrants will be exempt from the requirements to collect and keep current KYC information for the purposes of the suitability determination and from the suitability determination requirement itself in respect of a permitted client if the client has requested in writing that the registrant not make suitability determinations for the client's account and either:

- The client is an individual whose account is not a managed account; or
- The client is not an individual.

E. Training and Record-Keeping

Training: New subsection 11.1(2) of the Revised Rules requires registered firms to train their registered individuals on compliance with securities legislation including, among other things, the KYC, KYP and suitability determination requirements.

Recordkeeping: We think that for many firms, enhancing their client-facing and internal documentation (including written policies and procedures) so that these materials are fully aligned with the Revised Rules, represents one of the biggest changes brought about by the CFRs.

F. Implementation Timeline

Although the KYC, KYP and suitability provisions are scheduled to take effect on December 31, 2021, CSA members **do not** expect current registrants to have to update all their existing clients' KYC information or reassess the suitability of their investments as of that date. Rather, registrants should continue scheduling reassessments according to current requirements until the effective date and then schedule reassessments according to the triggers in the CFRs after that date.

4. A Closer Look at the Misleading Communications, RDI, Compliance Training and Record-Keeping Rules

This section highlights the new prohibitions on misleading communications as well as the relationship disclosure information (RDI), compliance training and record-keeping requirements. These provisions will come into effect on December 31, 2021.

A. Misleading Communications

Securities regulators and investor advocates have been concerned for years that some registered firms and individuals use confusing or misleading titles, designations, awards and/or other descriptions of themselves and their services. The securities regulatory framework already incorporates prohibitions that are broad enough to capture at least some of this conduct. For example, subsection 44(1) of the Ontario *Securities Act* prohibits people and companies from making statements that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading or advising relationship with that person or company if that statement is untrue or omits information necessary to prevent the statement from being false or misleading. Section 2.1 of Ontario Securities Commission Rule 31-505 Conditions of Registration requires registered dealers, advisers and representatives to deal fairly, honestly and in good faith with clients. And in 2011, the Canadian Securities Administrators (CSA) outlined their specific concerns and provided guidance to portfolio managers regarding the use of trade names and individual titles in marketing materials in Staff Notice 31-325 Marketing Practices of Portfolio Managers.

New section 13.18 of NI 31-103 reflects the securities regulators' conclusions that this principles-based approach is inadequate. The new rule, scheduled to come into effect on December 31, 2021, will prohibit registrants from holding out their services in any manner that could reasonably be expected to deceive or mislead any person as to:

- Their proficiency, experience or qualifications;
- The nature of the person's relationship or potential relationship with the registrant; or
- The products or services provided or that might be provided.

It also will prohibit registered individuals who interact with clients from using from any title or designation without their sponsoring firm's approval. In addition, they will be prohibited from using corporate officer titles unless appointed to that office under corporate law, and they will not be able to use any title, designation, award or recognition based on their sales activity or revenue generation.

The Revised Policy emphasizes that particular scrutiny should be given to titles that may convey an expertise in seniors' issues or retirement planning. It also recommends that firms consider whether a particular designation has a rigorous curriculum, examination process and experience requirements issued by a reputable or accredited organization when deciding whether to approve the designation's use.

As registrants develop their project plan for implementing these new requirements, they should also consider the following:

- The CSA has indicated that there is potential for further rulemaking on the use of titles and designations. In addition, in August 2020 the Financial Services Regulatory Authority of Ontario (FSRA) published draft rules to implement the *Financial Professionals Title Protection Act*, which will regulate individuals' use of "financial planner" and "financial advisor" titles in Ontario. Read more about FSRA's proposals in our August 2020 article. AUM Law will monitor these developments and keep you informed.
- As noted above, there are principles-based laws already on the books that could support enforcement action against a firm or individual for misleading communications. Therefore, although the official effective date for the new rules is December 31, 2021, we encourage firms to review their policies, procedures and practices in this area sooner rather than later.

B. Updated RDI Requirements

Section 14.2 of NI 31-103 has been amended to reflect changes with other CFRs (e.g. relating to conflicts of interest, KYC, KYP and suitability determination requirements) and, according to the CSA, to "better implement" the principle in subsection 14.2(1) that a registrant must deliver to the client "all information that a reasonable investor would consider important about the client's relationship with the registrant." Among other things, when revised section 14.2 comes into effect it will:

- Expand the existing requirement for registrants to provide a general description of the products and services that the firm offers to the client to include, as applicable, descriptions of any restrictions on the client's ability to liquidate or resell a security and any investment fund management expense fees or other ongoing fees the client may incur;
- Require registered firms to describe generally any limits on the selection of products or services that the registrant will offer to the client, including whether the firm will primarily or exclusively use proprietary products in the client's account;
- Require registered firms to explain generally the potential impact of operating charges, transaction charges, investment fund management fees, and any other ongoing fees the client might occur; and
- Expand the requirement for pre-trade disclosure to expressly require disclosure of investment fund management expense fees or other ongoing fees that the client may incur.

Also, the existing requirement to describe compensation paid to the registered firm in relation to the types of products a client might purchase will be broadened. It will require a general description of any benefits received or expected to be received by the registrant from anyone other than the registrant's client, in connection with the client's purchase or ownership of a security through the registrant.

The Revised Policy includes expanded sections on:

- Information to be included in the description of the nature or type of a client's account;
- Factors to consider in describing limits on the selection of products or services, including guidance emphasizing that a registrant is required to tell a client if it does not have products or services suitable for them; and
- When a firm is expected to provide a client with the KYC information it has collected (i.e. at the time of account opening and when the firm collects updated information).

The new RDI rules will take effect on December 31, 2021. AUM Law can help you prepare for the new regime by reviewing and updating your existing disclosure materials for clients, as well as the related policies, procedures and controls.

C. Compliance Training

Under the Current Rules and Policy, training is specifically addressed through:

- Prohibitions on registered individuals performing registrable activities, and chief compliance officers (CCOs) performing their responsibilities as CCOs, without having the education, training and experience that a reasonable person would consider necessary to perform the activity competently; and
- Language in the Current Policy indicating that registered firms should provide training, including ongoing communication and training on changes in regulatory requirements or the firm's policies

and procedures, to ensure that everyone at the firm understands the standards of conduct and their role in the compliance system.

Section 11.1 of NI 31-103 has been amended to introduce a broadly worded requirement for registered firms to provide training to their registered individuals on compliance with securities legislation, including without limitation the KYC, KYP, suitability determination and conflicts of interest requirements. This new rule is supplemented with guidance in the Revised Policy, which emphasizes the following concepts:

- A firm's compliance training will depend on the nature, size and complexity of its business. For some small firms, a formal compliance training program or written training materials might be unnecessary. However, the CSA will expect firms to exercise professional judgment in determining what training is appropriate for their operations.
- Although Section 11.1 of the Revised Rules speaks only to the need for firms to train registered individuals, the Revised Policy retain the concept that CSA members expect firms' training programs to ensure that **everyone** at the firm understands the standards of conduct when dealing with clients and understands their role in the compliance system. In our view, this broader definition of the firm's training responsibility can be seen as flowing from the existing requirement in section 11.1 for registered firms to have a system of controls and supervision sufficient to provide reasonable assurance that the firm and every individual acting on its behalf complies with securities legislation.
- Although the Revised Rule calls for compliance training on securities legislation generally, it and the Revised Policy specifically highlight the need for compliance training on the KYC, KYP, suitability, and conflicts of interest provisions. According to the Revised Policy, training should provide examples of how to:
  - Identify existing and reasonably foreseeable, material conflicts of interests between registered individuals and their clients;
  - Address material conflicts of interest in the client's best interest; and
  - Put the client's interest first when making suitability determinations.
- Consistent with the KYP requirements, firms also will be expected to assess whether any additional training or proficiency requirements are needed so that their registered individuals understand the securities and can make appropriate determinations.
- Firms can outsource elements of their training programs but remain responsible for demonstrating that their registered individuals have been trained on the firm's policies and procedures.
- Training programs should include "ongoing" communication and training on changes in regulatory requirements or the firm's policies and procedures.
- Firms will need to document their compliance training programs.

Although these specific, new compliance training requirements won't come into effect until December 31, 2021, we recommend that firms begin enhancing their compliance training programs soon, so that your employees become familiar with the CFRs. AUM Law offers compliance training programs tailored to your firm's needs. We can help you identify compliance gaps or topics that need reinforcement, determine who needs to be trained and when, develop the content for training sessions, update your compliance manual to reflect the new training requirements, and prepare the needed documentation to show that the compliance training requirements have been met.

D. Record-Keeping Requirements

Section 11.5 of NI 31-103 has been expanded so that registered firms will have to maintain records that:

- Demonstrate compliance with the new KYC, KYP and suitability determination requirements, the conflict of interest provisions in Part 13, Division 2, and the new requirements relating to misleading communications;
- Document training actions conducted by the firm; and
- Document the firm's sales practices, compensation arrangements and incentive practices as well as any other compensation arrangements and incentive practices from which the firm, any of its registered individuals or any of its affiliates or associates, benefit.

The Revised Policy provides detailed guidance on the kinds of records that it expects registered firms to keep. It also stresses the importance of firms maintaining adequate documentation to support the firm's **supervision** of its compliance processes in these areas. We expect that some of the more challenging aspects of these new requirements will include:

- Documenting suitability determinations and related supervisory measures (e.g. to address patterns of unsuitable trades); and
- Documenting the KYP process, including where the firm concludes that using proprietary products and services as opposed to a third party's products and services puts the client's interests first.

In addition to presenting some conceptual challenges, some of the new record-keeping requirements (such as documentation of conflicts of interest, sales practices, compensation arrangements, and incentive practices) will require a substantial deployment of firm resources to design and maintain.

5. CSA Publishes FAQ Guidance on the CFRs

On September 28, 2020 the CSA published guidance in the form of responses to frequently asked questions (FAQs) from registrants about how to interpret and implement the CFRs. The September 28 publication covers 34 topics and the CSA expects to publish responses to additional FAQs the compliance deadlines for the CFRs approach. In our first look at the FAQs, we noted with interest the following topics:

Closed-Shelf Firms: Several FAQs address issues relevant for firms that only sell proprietary products (Closed-Shelf Firms):

- **Comparative Analysis of Competing Products Encouraged but Not Required:** In their response to FAQ 9, CSA staff indicate that Closed-Shelf Firms do not have to compare their proprietary products to similar securities available in the market. However, CSA staff also suggest that periodically evaluating whether the firm's proprietary products are competitive with alternatives in the market is one way a firm can demonstrate that its product shelf development and client recommendations are based on the quality of the proprietary products that it makes available to clients. This does not mean, however, that the firm must use the information gained from such an analysis either to change the products it makes available to clients or perform a shelf optimization. However, the information gained from such an assessment might inform the firm's analysis of whether its controls to address the conflict of interest inherent in its business model are sufficient.

- **Assessing Competitors' Prospectus-Exempt Products:** CSA staff's response to FAQ 11 acknowledges that it can be difficult to compare proprietary products to alternative products offered on a prospectus-exempt basis due to limits on publicly available information. They also stated, however, that most registrants and issuers have a general knowledge of the competitive space in which they operate and are able to gather enough information to understand how they or their offerings compare with others in that space. Staff also emphasized that if there are specific limitations to the information registrants can obtain, or necessary assumptions or caveats registrants have to make in their comparative analysis (for example, because competitive products are materially different), these limitations and assumptions should be documented. Staff also indicated that generally they will expect firms to be familiar with its competitors' products at least at a high level.
- **Know-Your-Product (KYP) for Non-Proprietary Products Offered on an Incidental Basis:** FAQ 11 also asks what level of due diligence is expected where a registered firm mostly offers proprietary products but may recommend certain non-proprietary products on an ancillary basis. In their guidance, CSA staff emphasize that firms operating under a 100% proprietary model **do not** have to include non-proprietary products on their shelf or recommend them. However, if a firm incidentally recommends non-proprietary products, then the incidental nature of the recommendation doesn't reduce the firm's KYP obligations for that product. Also, the firm should document its due diligence and, from a conflicts and suitability perspective, document why it has chosen to recommend a particular non-proprietary product over others.

Conflicts of Interest

- **When is a Conflict Material?** CSA staff's response to FAQ 5 asking for further guidance on the concept of "material conflicts" does not provide any new information. Staff reiterated the guidance expressed in the revised Companion Policy to NI 31-103 (Revised Policy) that, in determining whether a conflict is material, registrants should consider whether the conflict may reasonably be expected to affect, in the circumstances, the client's decisions and/or the registrant's recommendations or decisions. They also pointed to their guidance in the Revised Policy listing the conflicts that they consider to be "almost always material".
- **Best Interests Standard:** In FAQ 4, market participants sought more guidance on how they can ensure that they are addressing material conflicts of interest in the best interests of their client. CSA staff's response, however, does not provide much additional information. Staff reiterate their prior statements that determining best interests is a facts and circumstances-specific exercise, point to their guidance in NI 31-103CP regarding conflicts, and stress that a registrant's conflicts analysis should take into account materiality, reasonability and professional judgment, taking into account the client-registrant relationship and the registrant's business model.
- **Conflict of Interest Records:** FAQ 12 asked the CSA for more guidance on the level of detail required in conflict of interest records. CSA staff's response emphasizes several points:
    - As the materiality of the conflict increases, there should be greater detail in the records maintained to demonstrate compliance.
    - The CSA has not prescribed a specific format for such records. However, staff expect firms to, at a minimum, document their identification, review and analysis of conflicts of interest, their determination as to whether a conflict is material, and the controls used by the firm to ensure that material conflicts have been addressed in the client's best interest.
    - The firm's documentation can be part of its risk assessment or conflicts of interest assessment, and it can include cross-references to the firm's policies, procedures and controls.

- Paragraph 11.5(2)(q) of NI 31-103 will require firms to create a complete record that documents sales practices, compensation arrangements, and incentive practices, and the guidance in section 11.5 of the Revised Policy describes what must be documented.

- **Consent (or Disclosure + Consent) Aren't Enough:** In their responses to several FAQs, CSA staff emphasized that once the CFRs are in effect, consent (or disclosure plus consent) without other action by a registrant will be **insufficient** to address a material conflict of interest in a client's best interest. (FAQs 6, 7 and 11) Additional controls (such as pre-trade controls and/or post-trade reviews) must be used. In FAQ 7, CSA staff also indicate that if a client opens an account after receiving clear disclosure that the dealer or adviser will be using proprietary products, it is reasonable to assume that the client agreed to a client-registrant relationship on that basis. However, the dealer must also take other steps to address the conflict before it can proceed, and it cannot rely solely on the issuer or an affiliate for its product due diligence.
- **Conflicts Disclosure:** FAQ 15 asks whether conflicts can be grouped for disclosure purposes or whether they must be specifically enumerated. In their response, CSA staff stress that they do not want the disclosure to overwhelm clients but that some specificity is needed to help clients evaluate their relationship with the registrant. Registrants should use their professional judgment in deciding whether grouping certain conflicts together will result in the client being able to more easily understand the disclosure.

Know-Your-Client (KYC) and Suitability Requirements

- **Collecting Information about Outside Holdings:** In their response to FAQ 2, CSA staff provide guidance on how they expect registrants to handle situations where they do not have access to information about a client's outside holdings, which may be relevant to the registrant's assessment of the client's capacity for loss. In particular, CSA staff expect dealers to obtain a breakdown of the client's financial assets and net assets to ensure that the information collected accurately reflects the client's financial circumstances and to assist the registrant in determining the availability of prospectus exemptions the suitability of any investment made. Outside investments may be particularly important to an assessment of whether a particular investment could lead a client to become over-concentrated in a security. Staff indicated, however, that if a client refuses to provide or update the requested information, that refusal does not automatically prevent the registrant from servicing the client. The registrant should use professional judgment in deciding whether it has sufficient information to meet its suitability determination requirement and whether that information is sufficiently current. Furthermore, staff expect dealers to make further inquiries where there is a reasonable doubt about the accuracy of information provided by the client or the validity of the client's claim to be an accredited investor or eligible investor.
- **Unsolicited Orders:** In their response to FAQ 2, CSA staff also remind registrants of the new requirement, set out in section 13.3(2.1) of NI 31-103, regarding unsolicited orders. If the registrant believes that a client order or instruction isn't suitable, it's insufficient to mark the order as unsolicited. The registrant must advise the client in a timely manner against proceeding, indicate the basis for that determination, and recommend an alternative that satisfies the suitability requirement in subsection 13.3(1). In order to provide such advice, the registrant must have sufficient KYC information.
- **Evidencing Compliance with KYC Update Requirements:** In their response to FAQ 3, CSA staff emphasize that they have not prescribed how registrants must evidence their compliance with obligations to keep KYC information current. They note that methods for documenting a client's confirmation of the accuracy of information, including significant changes, may include maintaining notes in the client's file or more formal methods such as obtaining the client's digital

or handwritten signature. In some cases, notes of a phone call will be enough but in other situations (e.g. where there are significant changes in KYC information), staff expect that information to be repapered. Also, when a periodic review takes place, CSA staff expect all KYC elements to be reviewed. It wouldn't be reasonable to update a client's income or employment without asking questions to revisit their risk tolerance and time horizon.

- **Reassessing Suitability When Team Membership Changes:** Section 13.3.(2)(a) of revised NI 31-103 (the Revised Rule) requires a registrant to review a client's account and reassess the suitability of the securities in that account if, among other things, a registered individual is designated as responsible for the client's account. In FAQ 26, CSA staff provide guidance on how that requirement can be interpreted where a firm assigns teams, rather than specific individuals, to client accounts. They indicate that professional judgment must be exercised in deciding whether a change in team membership triggers a suitability review. For example, a change of one registered individual will not necessarily trigger the requirement but individual team members' roles and responsibilities, to the extent they differ, should be considered. For example, if there is a team leader who approves other team members' recommendations and that team leader changes, it is likely that a review would be appropriate because that individual is effectively designated as responsible for the client's account.

Referral Arrangements: The response to FAQ 17 reiterates that when a firm refers a client to a service provider, the firm is responsible for conducting oversight over that service provider. The response also outlines steps that registrants can take to conduct due diligence on prospective referral parties and then supervise any referral arrangements they enter into. CSA staff expect registrants to consult publicly available databases and search engines, and make inquiries of the other party (whether registered or not) to ascertain, for example:

- The referral party's status (including licensing or registration status), financial health, professional qualifications and history;
- Whether the referral party has been the subject of any investigation by a securities or financial sector regulator, any disciplinary action relating to their professional activities under their governing body or organization; and
- Whether there have been complaints, civil claims and/or arbitration notices filed against them in relation to their professional activities.

Due diligence records must be maintained. CSA staff also list examples of controls that can be used to monitor referral arrangements, including:

- Ongoing assessment of compensation received by registrants under referral arrangements;
- Ongoing compliance calls to investors who have been referred to or by the firm to assess how the process is being conducted by each referral party;
- Annual questionnaires sent to registrants receiving referral fees regarding the nature and extent of their involvement in referral arrangements;
- Interviews of registrants receiving referral fees during the branch review process;
- Requiring unregistered referral agents who make referrals to the firm to: (1) attend training on how to conduct referrals; and (2) use only pre-approved marketing materials and social media content in relation to their referral business; and
- Assessing complaints and other information received in connection with referral arrangements to ensure compliance by all referral parties.

Relationship Disclosure Information (RDI) Requirements

- **Timeline:** Now that the deadline for implementing the revised RDI requirements has been extended to December 31, 2021, CSA staff expect all new and existing clients to receive updated RDI in line with that deadline (FAQ 21).
- **Delivery Mechanisms and Content:** CSA staff's response to FAQ 21 also emphasizes that registrants have flexibility about how they deliver the revised RDI. For example, the information could be provided to a new client during onboarding, while an existing client could receive the information when the registrant first interacts with that client after the implementation date. If an existing client has opted to receive correspondence electronically, firms should provide the s. 14.2 disclosure to that client by December 31, 2021 to the extent feasible. Staff also stress that, to satisfy s. 14.2, registered individuals must spend enough time with the client to adequately explain the information being delivered to the client, including an explanation of any changes to the RDI being delivered to the client. Finally, CSA staff encourage registrants to assess the effectiveness of the disclosure they provide to clients by considering behavioural economics principles and tactics to simplify the content.
- **Standalone Conflicts Disclosure:** FAQ 22 doesn't expressly incorporate a question, but it seems to seek the CSA's confirmation that firms will not have to mail out a separate disclosure document disclosing material conflicts of interest by June 30, 2021. In their response, CSA staff point out that the required conflicts disclosure to new and existing clients cannot be delayed past the June 30, 2021 deadline. However, the disclosure can be provided electronically or on paper, provided that it meets the CFRs' plain language requirements. In addition, registrants that are not required to be members of the Investment Industry Regulatory Organization of Canada (IIROC) do not have use a prescribed RDI document to deliver the account opening conflict of interest disclosure.
- **Disclosure about Fees, Expenses and Operating Charges:** CSA staff's responses to FAQs 23 and 24 go beyond the guidance in revised NI 31-103CP to set out some additional factors and principles to consider in crafting RDI to meet the requirements in sections 14.2(2)(b)(ii) and 14.2(2)(o). Among other things, staff state the following:
  - Since fee models and products and services offered to clients vary widely, registered firms will have to exercise professional judgment as to the extent they can standardize disclosure, how client-specific it can be, and how much detail is needed. They also will need to strike the right balance between providing "enough information" and not overwhelming the investor.
  - Subparagraph 14.2(2)(b)(ii) of NI 31-103 does not require the firm to provide the client with a list of **all** investment funds and other products with ongoing fees and expenses. Rather, it is to inform clients who may be invested in such products or services that those investments have ongoing fees and expenses. For example, staff would expect disclosure in plain language about how fees and expenses are taken from the fund as a percentage of its total assets, how the fees and expenses will be deducted from the fund's returns (and therefore will affect the client's returns on their investment for as long as they hold the fund), and that when the client gets information about the value of their investment in the fund, the fees and expenses have already been taken into consideration.
  - The requirements for transaction charge disclosures in RDI are for "a general description" of the **types** of transaction charges that **the** client might be required to pay. This means that types of fees that the firm does not currently use for clients like the individual receiving the RDI should be excluded. It also means that the details of the amounts relating to a specific security should not be included in RDI.

- The requirement to disclose operating charges is not qualified as a "general description". It is specific to what the firm might charge the client related to the account. This is because RDI is deliverable at account opening and the specific details about the cost of having the account are therefore relevant at that time.
- The requirement relating to the potential impact of fees and charges is for a "general description" but it is specific to the types of transaction charges and the actual operating charges (if any), as well as the investment fund management fees or other ongoing fees the client may incur in connection with a security or service, applicable to the client's account. The most evident impact is that investment returns will be reduced in proportion to the fees and charges.
- Firms should not provide generic summaries of the kinds of charges that are used in the industry or a sector of it.
- A firm with a simple AUM-based fee model can be much more specific and more readily use numerical examples than one that relies on a mix of transaction fees and trailing commissions paid on products that it sells to clients.
- Firms are encouraged to use graphics as well as text in order to make the information understandable to as many clients as possible.

Training: In their response to FAQ 1 regarding training on conflicts of interest, CSA staff indicated that registrants should exercise professional judgment in developing training materials and determining which staff require the training. They also said that:

- They expect firms to train "all appropriate staff" on conflicts of interest generally, and this would include all registered individuals, all supervisory staff, and additional staff (including compliance staff) depending on their roles and responsibilities.
- Training on the firm's code of conduct, which generally includes training on conflicts of interest policies, procedures and controls may be sufficient to evidence training of staff on conflicts of interest generally.
- Specific training modules for certain material conflicts also may be required for certain staff (e.g. training on compensation-related conflicts may be needed for all registered individuals and compliance/supervisory staff).

Supervisory Staff Compensation: CSA staff discuss approaches to supervisory compensation in their response to FAQ 10. They state, among other things, that they expect the majority of the compensation of supervisory staff to not be tied to the revenue generation of representatives, the branch, or the business line that supervisory staff oversee. If, however, a portion of supervisory staff compensation is tied to branch or business line profitability, CSA staff expect that:

- The other compensation factors should be sufficient to outweigh any bias that supervisory staff might have toward profitability over the clients' best interest;
- Controls such as multiple level supervision should be in place to ensure head office or an otherwise independent review of the supervisory process; and
- Compensating controls should be tested periodically for effectiveness.

Staff also recommend that firms consider compensating controls such as setting a low level of bonus relative to base salary combined with strict measures that penalize non-compliance, such as tying supervisory staff's bonuses (or even salaries) to:

- Branch and direct reports not receiving valid investor complaints; and

- Results from independent quality assurance calls to investors to assess compliance and sales practices.

If/When Updates to Guidance Can Be Expected: FAQ 27 asks whether there is a comprehensive list of guidance and staff notices that the CSA and/or the self-regulatory organizations (SROs) expect to revise or rescind. In particular, market participants asked if guidance published by IIRCO and the Mutual Fund Dealers Association of Canada (MFDA) regarding personal financial dealings will be revised or rescinded. CSA staff state that:

- If there is an inconsistency between language included in prior CSA guidance and the CFRs, the CFRs prevail to the extent they impose requirements or set out more current guidance.
- The CSA proposes to review earlier guidance and may revise it or rescind it at a later stage. The FAQ guidance does not provide any specifics about what will be reviewed or when such a review will take place.
- IIROC does not expect to issue new guidance on personal financial dealings.
- The MFDA intends to revise "all [presumably relevant] guidance". In particular, MSN-0047 Personal Financial Dealings with Clients will be revised but no changes to MSN-0031 Control or Authority over the Financial Affairs of a Client are expected.

6. Next Steps: How AUM Law Can Help

AUM Law offers practical, cost-effective legal and regulatory compliance advice from a team that prioritizes your business and understands your industry. We focus on the Canadian asset management sector, and we have deep expertise in the legal and regulatory issues relevant to firms operating in Canada's exempt and public capital markets. Our team-based approach, fixed-fee compliance support plans, extensive experience engaging with securities regulators, and connections with other service providers in this industry will help you navigate the path to implementation of the CFRs with confidence so that you can focus on what you do best.

Registrants should view the implementation process as a marathon, not a sprint. And just like aspiring marathoners, registrants should start regularly putting in the needed hours beginning now, if they haven't already started.

If you aren't already taking advantage of our fixed-fee compliance support plans, this is a great time to sign up. Our plans can help you manage your existing regulatory compliance obligations together with the incremental workload associated with implementing the CFRs while spreading the cost for legal services evenly across the year. Within the framework of a compliance support plan, we can:

- Help you understand the implications of the CFRs for your business;
- Conduct a compliance gap analysis;
- Develop a pragmatic implementation program (including a compliance calendar) tailored to your business;
- Revise your policies, procedures and client-facing documentation as needed;
- Update your record-keeping protocols;
- Develop or enhance your compliance training program so that it meets the new requirements and ensures that your employees are familiar with the CFRs; and
- Help you document your implementation program so that you can show the regulators that you are taking your new responsibilities under the CFRs seriously.

These plans also include a "bucket" of general counsel hours to use AUM Law as in-house counsel, so that you have cost certainty and flexibility to call us about any legal issue pertaining to regulatory compliance, investment funds or other matters falling within our areas of expertise. Alternatively, we can provide you with á la carte regulatory and compliance support services, often on a fixed-fee basis, to help you address discrete aspects of your CFR implementation program.

Please contact Erez Blumberger, Kevin Cohen or Kimberly Poster or your usual lawyer at AUM Law for assistance. If you're not already a client, request a free consultation.

Erez Blumberger
President
416 966 2004 x235
eblumberger@aumlaw.com

Kimberly Poster
Chief Legal Counsel & Senior Vice President
416 966 2004 x266
kposter@aumlaw.com

Kevin Cohen
Chief Executive Officer
416 966 2004 x225
kcohen@aumlaw.com

Practical Advice • Efficient Service • Fixed-Fee Plans

AUM Law focuses on serving the asset management sector in the areas of regulatory compliance and investment funds. We also support clients in this sector by providing legal advice and services for structuring entities, raising capital, business combinations, and compliance with reporting issuers' and investors' disclosure obligations. Our clients include investment fund managers, portfolio managers, dealers, public and private investment vehicles including real estate funds, alternative funds and private equity funds, investors, and private and public companies.

AUM LAW

This bulletin is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this bulletin without a thorough examination of the law as applied to the facts of a specific situation.