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Ontario Securities Commission
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Dear IIROC and the OSC:

Re: Client Focused Reforms – Proposed Rule Amendments for Public Comment and Proposed Product Due Diligence and Know-Your-Product Guidance

The Investment Industry Association of Canada (the "IIAC") appreciates the opportunity to comment on the above noted Client Focused Reforms ("CFRs") Proposed Rule Amendments and Proposed Product Due Diligence and Know-Your-Product Guidance (the "Proposed Guidance").

The IIAC has supported the regulators' efforts to enhance the client-registrant relationship by working with the Canadian Securities Administrators (the "CSA") and the Investment Industry Regulatory Organization of Canada ("IIROC") to develop and implement the CFRs to better align the interests of securities registrants with the interests of their clients.

As we noted in our 2018 Submission to the CSA, one of the key benefits of the CFRs is the harmonized approach to implementing the reforms. We are supportive of IIROC's efforts to ensure its rules are materially uniform with those of the CSA, while addressing the unique business models of IIAC members.

Outlined below are our issues and concerns regarding aspects of the CFR Proposed Rule Amendments and Proposed Guidance where we believe additional clarification may be required or where differences from the CSA requirements should be harmonized.

Know-Your-Client Requirements

1. *Transition for existing clients*

The IIAC requests confirmation that there is no expectation that know-your-client ("KYC") information will be updated for existing clients as of the implementation date and that registrants will only be expected to schedule reassessments in accordance with the KYC triggers in the Proposed Rule Amendments after the implementation date.

Further, we would like confirmation that the triggers for updating KYC information are limited to those in subsections 3209(3) and (4), respectively. We believe that the triggers in subsection 3402(2) are suitability reassessment triggers – and not KYC update triggers.

The above is consistent with the transition period provided for in IIROC Notice 20-0239 and CSA Notice of Amendments to NI 31-103. The IIROC Notice 20-0239 only references KYC triggers and states:

> We do not expect Dealers to conduct a complete repapering of all their clients' KYC information because of these changes prior to their implementation date, December 31, 2021. 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.

Further, the CSA Notice of Amendments to NI 31-103 makes a distinction between KYC updates and suitability reassessments. The CSA transition period provides that a suitability reassessment can occur without a corresponding update in KYC information.

We recommend that IIROC provide guidance that there is no expectation that KYC information be updated for suitability triggers that occur between the implementation date and a KYC trigger (the earlier of a 1-year or 3-year update, or a significant change in the client's information).

2. *Rule 3208 Exemptions from Know-Your-Client*

The IIAC requests an exemption/waiver from clause 3202(1)(iii) and subsection 3209(4) for an individual permitted client. We believe it is appropriate for individual permitted clients to either be exempt from these KYC requirements or to have the ability to waive them. IIROC, in its Request for Comments on Proposed Derivatives Rule Modernization, Stage 1 (Notice 19-0200) released in November 2019, outlined that it proposed extending the "assets under administration" approach for institutional clients to individual clients, subject to certain conditions.

3. *Know-Your-Client IIROC Guidance*

The IIAC anticipates that IIROC will release guidance with respect to expectations for KYC and suitability. We request clarification on the below points be included in the guidance to assist firms.

Subsection 3202(3) will require dealers to take reasonable steps to have a client confirm the accuracy of their KYC information. We seek confirmation that this requirement can be satisfied for Order Execution Only ("OEO") firms where: (i) clients provide instructions to update their KYC information and provide confirmation of their updated KYC information during a recorded telephone call; and (ii) clients have the ability to view their KYC information through their online account.

In addition, subsection 3209(3) will require dealers to update client KYC information after becoming aware of a significant change in a client's information. OEO dealers do not conduct suitability assessments, and interactions with clients are generally through online channels or through a contact center. We seek confirmation that such firms fulfill the requirement when they act on client instructions to update their client information on file.

Sub-clause 3202(1)(3)(a) will require dealers to collect information regarding a client's personal circumstances. The CSA Companion Policy 31-103 ("31-103CP") indicates that personal circumstances include whether someone other than the client has a financial interest in the account. If IIROC intends to adopt similar guidance, we request that IIROC indicates whether compliance with this aspect of the new-personal-circumstances KYC requirement is met through compliance with the IIROC rules that require identification of beneficial owners and beneficiaries, and anti-money laundering regulations that require dealers to determine whether an account is to be used by or on behalf of a third party.

IIROC CFR Suitability Amendments

1. *Subsections 3209(4), 3402(2)(v) and 3215(4) Discretionary Accounts*

Discretionary accounts, by definition, cannot have a term exceeding 12 months in length. Subsections 3209(4), 3402(2)(v) and 3215(4) reference requirements for managed accounts and discretionary accounts with respect to updating client account and KYC information no less frequently than once every 12 months or using account documentation that was approved within 12 months. Given the restrictions on the term length for discretionary accounts, the IIAC believes that the discretionary account requirements related to updating client account and KYC information should be separated from managed accounts in order to avoid any confusion. For example, section 3215 could be revised to the following:

> 3215 Updating Client Accounts
>
> (4) If the client's *managed account* application was approved within the past 12 months, *the Dealer Member* may use a copy of a client's current *managed account* application to record any changes to a client's information, but must have the *Registered Representative*, *Portfolio Manager* or *Associate Portfolio Manager* and their *Supervisor* initial any changes.
>
> (5) As the client's discretionary account application was approved within the past 12 months, *the Dealer Member* may use a copy of a client's current *discretionary account* application to record any changes to a client's information, but must have the *Registered Representative* and their *Supervisor* initial any changes.

2. Subsection 3211

IIROC Notice 20-0238 outlines the account appropriateness requirement that applies to members prior to opening an account. We understand the objective of the proposed requirement outlined in IIROC Notice 20-0238; however, we believe the wording proposed in subsection 3211(1) does not clearly correspond to the intended requirement.

IIROC Notice 20-0238 refers to an obligation to determine account suitability for the person, yet the section requires that a firm determine that it is suitable for the person to be a client of the Dealer Member. Such wording implies that the dealer's obligation is to determine whether Dealer Member A would be more suitable than Dealer Member B for that client. As such, the IIAC is of the view that the reference to "Dealer Member" in clause 3211(1)(i) be removed. We believe this section should be revised to clearly express that the requirement is to ensure that the account itself is appropriate. We have included potential revised wording below:

> 3211(1) Before a Dealer Member opens an account for a person, the Dealer Member must determine, on a reasonable basis and putting the person's interest first, that:
>
> (i) **The account is appropriate for the person;**

In addition to the above requested changes, the IIAC requests an exemption from the account appropriateness provisions for (i) institutional clients that are permitted clients and who waive suitability; and (ii) individuals who are permitted clients and who waive suitability for non-managed accounts. These clients are deemed to have the level of sophistication necessary to waive other suitability obligations.

3. Subsections 3402(3) and 3403(4)

The IIAC believes that subsections 3402(3) and 3403(4) unnecessarily complicate how firms are to conduct suitability determinations and should be removed. The requirements fail to indicate when and how often after an account is opened dealers are expected to conduct account appropriateness reviews. We believe that subsections 3402(1), 3402(2) and 3204(4) adequately capture the requirement to determine account suitability for the client. Account suitability requirements are drafted in a similar fashion in NI 31-103.

Further, clauses 3402(3)(i) and 3403(4)(i) are drafted to apply to OEO dealers, which is problematic as the requirements would require an ongoing suitability determination. Under clause 3208(1)(i), OEO dealers are exempt from collecting certain KYC information and thus would not have the necessary information to conduct an ongoing suitability review. OEO firms will have an account appropriateness obligation pursuant to section 3211 to determine if an OEO account is appropriate for the person. We believe it is not appropriate for OEO dealers to conduct suitability determinations beyond the initial account appropriateness requirement in section 3211.

In addition, we question how this requirement could be effectively operationalized by OEO dealers. IIROC Notice 18-0076 notes that it may not be appropriate for a person to become a client of an OEO firm if they have difficulty completing the OEO account forms online or are seeking advice. It is not clear how OEO

dealers would be expected to assess similar or broader criteria on an ongoing basis. The removal of subsections 3402(3) and 3403(4) would address these concerns, as OEO dealers are exempt from 3402(1).

4. Sections 3402 and 3406 and model-traded managed accounts

The IIAC notes that section 3402 contemplates that a firm exercising discretion over a managed account must determine that each trade or exercise of discretion is suitable for each client, and must document proof that all suitability criteria were addressed and that the action puts the retail client's interest first.

IIROC rules currently permit a firm to operate a managed account where a third party hired by the firm manages the account, or the discretionary portfolio strategy is based – in whole or in part – upon a model strategy where trade decisions are made centrally and applied across accounts enrolled in the model strategy. Portfolio changes initiated by the third-party manager or model and executed by the firm are not based upon any consideration (with a low weighting or otherwise) of a particular client's financial situation, personal circumstances, etc. The portfolio changes initiated by the third-party manager or model follow an Investment Policy Statement ("IPS"), and it is the firm's responsibility to determine suitability of that IPS for each particular client, similar to the manner in which suitability of an investment fund product is determined for a client. Overall, the suitability of the transactions and exercise of discretion for each client is maintained for the managed account, but documentation that suitability considerations were made for each such transaction or exercise of discretion will likely not meet the regulatory expectations.

The IIAC recommends that section 3406 be clarified such that the prohibition against delegation does not apply to the discretionary or managed accounts operated in accordance with clause 3279(1)(iii), and that compliance with the suitability determination can be met based upon information provided by third parties, such as an investment policy compliance certificate.

5. Subsection 3402(4)

Subsection 3402(4) states that a dealer is required to determine, on a reasonable basis, if an investment action would be suitable for the retail client's investment portfolio. The term "investment portfolio" is not defined, and could imply a multiple account suitability determination.

Further, the language in subsection 3402(4) appears to be broader than section 13.3 of NI 31-103, which requires an assessment of suitability at the account level. It is also broader than the portfolio approach to suitability outlined in 31-103CP, which is limited to the assessment of concentration and liquidity only, and does not consider all suitability factors. Where a retail client has multiple accounts within a single registrant, 31-103CP requires the registrant to "take into consideration whether a recommendation or decision for one account would materially affect the concentration and liquidity of the client's investments across all their accounts held with the firm".

In addition, the IIAC previously raised concerns with the CSA that 31-103CP guidance is problematic for firms that have various business lines within a single registrant. For example, both subsection 3402(4) and 31-103CP as currently expressed, could require an advisor to consider suitability for the client's advisory account and an OEO account if each account is held within a single registrant. The advisor should not be

providing any suitability-related advice on the OEO account. Another example is when entities have multiple business lines within a single registered firm, that operate, effectively as separate registrants. This prevents an advisor from looking into accounts the client may have within different business lines. The CFR Implementation Committee has recognized these concerns and released additional guidance as part of its December 18, 2020 FAQ, clarifying their views with respect to the portfolio approach to concentration and liquidity factors when conducting a suitability determination.

As a result, we recommend that the language in subsection 3402(2) be revised to reflect that the suitability determination is based on the account's current investment portfolio composition. We suggest the below revision to ensure the intent of the requirements is clear:

> 3402(4) When making a suitability determination pursuant to subsection 3402(1), a *Dealer Member* must determine on a reasonable basis, that the *retail client's* **investment portfolio within the *retail client's* account** that would result from the investment action the *Dealer Member* takes, recommends or exercises discretion to take is suitable for the *retail client* and puts the *retail client's* interest first.

Further, we recommend that when IIROC releases its revised suitability guidance, it introduce similar clarifications to those issued by the CFR Implementation Committee regarding its expectations surrounding the portfolio approach to concentration and liquidity factors when conducting a suitability determination.

While the requirement for subsection 3402(4) should clarify that it is an account level suitability determination, we believe the current flexibility provided to firms to conduct suitability determinations on a multiple account basis should be maintained as outlined in IIROC Guidance Note 12-0109. We request that IIROC include confirmation of multiple account suitability in its revised suitability guidance.

Proposed Product Due Diligence and KYP Guidance

1. 1.1 What is product due diligence?

While the IIAC appreciates the intent behind paragraph 2 of the Proposed Guidance which includes examples of securities that dealers may conclude should not be available to retail clients, we are concerned that these suggestions reduce the advisor's ability to use their professional judgment as to what products are suitable for their clients. The language suggests elements of a suitability analysis in the dealer's due diligence requirements. The CSA revised 31-103CP to remove similar references to firms creating guidelines of securities for classes of clients. We therefore recommend that IIROC remove paragraph 2 from the Proposed Guidance.

Further, the language "examples of such securities include, but are not limited to" can be interpreted to conclude that certain products should not be made available to any retail client. If this paragraph is to remain in the Proposed Guidance, we recommend the following language be included:

> For example, where a Dealer determines that a particular security has complex or unique features making it difficult to fully understand, the Dealer may conclude that the security should not be made available to a certain class or subset of retail clients.

This language will support a dealer's suitability obligations. Further, this will also allow advisors to apply their professional judgement about whether the product remains suitable for the client.

2. 1.1.3 Is the product due diligence responsibility the same for all types of business models?

The IIAC appreciates that IIROC continues to acknowledge the need for flexibility in how members meet their product due diligence obligations. The IIAC recognizes that OEO dealers are not exempt from the due diligence requirements; nevertheless, we are concerned with the statement regarding the minimum an OEO dealer is expected to do for OEO accounts, as it appears to project aspects of suitability obligations on these firms. Any suggestion by IIROC in the Proposed Guidance that OEO dealers will be conducting product suitability determinations, is in direct contradiction to dealer obligations and client expectations. We note that sub-clause 3241(2)(i)(c), requires OEO dealers to provide clients with a statement "confirming that the Dealer Member will not be responsible for making a determination that the products and account types offered by the Dealer Member in the order execution only account are appropriate for the client."

We therefore request that the sentence, "At a minimum, the product due diligence obligation for OEO accounts will include a determination regarding whether certain products should be made available for any clients" be removed from the Proposed Guidance.

3. 1.1.5 What product due diligence is required for transfers-in and client directed trades?

In general, the IIAC is supportive of the additional guidance provided in 1.1.5 related to requirements for transfers-in. However, the section currently only addresses instances where an advisor recommends reducing the client's holdings of the transferred-in security, and is silent where the advisor recommends that a client continue to hold the security. We believe that firms should not be required to conduct further due diligence where the recommendation is to continue to hold the security. We request the following revisions to this section, to include a reference to holds:

> Any further recommendations, **apart from the recommendation to hold or reduce** client holdings of the transferred-in security, will require the security to be subject to the Dealer's product due diligence review process.

4. 1.4 What are the key considerations when conducting product due diligence?

While the Proposed Guidance does state that firms have flexibility in how they conduct due diligence based on their business models, we believe there should be greater clarification in 1.4 that the factors listed may not be applicable to all business models. For example, OEO dealers should be able to tailor their list of factors to be assessed as part of the product due diligence process, as many of the factors listed in the Proposed Guidance would not be applicable to their business model; such as the type of

investor the security is appropriate for, the training required for Approved Persons who trade in or advise on the security, etc.

Thank you for considering our comments. We would welcome an opportunity to discuss this submission further should you have any questions.

Yours sincerely,

"Michelle Alexander" *"Adrian Walrath"*