VIA E-MAIL

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Re: CIRO Rule Consolidation Project – Phase 1

The Portfolio Management Association of Canada (**PMAC**) is pleased to have the opportunity to submit the following comments on the CIRO Rule Consolidation Project – Phase 1 (the **Consultation)**.

PMAC represents over 320 investment management firms registered to do business in Canada as portfolio managers (**PMs**) with the members of the Canadian Securities Administrators (**CSA**). PMAC's members encompass both large and small firms and manage total assets in excess of $3 trillion as fiduciaries for institutional and private client portfolios.

PMAC's mission statement is "advancing standards". We are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit the capital markets as a whole. We generally support the objectives of the Consultation and agree that the rules pertaining to Investment Dealers (**IDs**) and Mutual Fund Dealers (**MFDs**) should be harmonized to minimize regulatory arbitrage.

KEY RECOMMENDATIONS

1. **Eliminate the offering of discretionary account arrangements; in the interim, limit the dealer types that can offer this account type to investment dealers; and,**

2. **Continue the offering of managed accounts through portfolio managers and investment dealers only.**

DISCUSSION

Although we support CIRO undertaking the rule consolidation, we also believe that different registration categories, business models and client types may require different types of regulation. In particular, managing client portfolios through discretionary authority should be subject to a fiduciary duty, to act fairly, honestly and in good faith toward the client and in the client's best interest.

We have focused our comments on section 2.2.2 of the Consultation, *Rules to clarify the scope of activities*. We agree with the change to clarify that discretionary accounts are only available to ID Members. We also support maintaining the status quo with respect to offering managed accounts through ID Members and PMs only.

Question #2 - Temporary discretionary accounts

We agree that there is no longer a need to make temporary discretionary account arrangements available to clients. We agree that this account type should be eliminated.

Question #3 – Account types that can be offered by Investment Dealer Members and Mutual Fund Dealer Members

Should we consider proposing to allow Mutual Fund Dealer Members to offer managed accounts and order execution only accounts a spart of a future Rule Consolidation Project phase and provided they comply with requirements that are materially the same as those that apply to Investment Dealer Members? Any such changes would have to be developed in conjunction with the CSA.

We strongly oppose any proposal to expand the use of managed accounts to Mutual Fund Dealer (MFD) Members.

In 2019, the MFDA proposed amendments to MFDA Rule 2.3.1(b) (Discretionary Trading) (**2019 Proposal**) to allow MFDA Members limited discretion to permit rebalancing of model portfolios. The current Consultation question regarding the ability of MFD Members to offer managed accounts appears to suggest an even

broader use of discretion, and raises all of the same concerns we expressed in our response to the 2019 Proposal.

From an investor protection point of view, PMAC is concerned about MFD Members and their Approved Persons not having the same proficiency and regulatory obligations of PMs if they are permitted to manage client assets on a discretionary basis. In our response to the 2019 Proposal, we expressed our view that MFD Members be required to register as restricted PMs in order to engage in (limited) discretionary trading. We continue to believe that this would establish an appropriate standard of capitalization, insurance, and regulatory oversight and proficiency.

We also noted that, since the Companion Policy to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103 CP**) provides broad discretion to the CSA to determine the education and experience required to register as the Chief Compliance Officer (**CCO**) of a restricted PM, minimum proficiency criteria would need to be developed to apply to the CCO of a MFD Member firm to support the discretionary trading being done by the firm.

With respect to ongoing compliance obligations, we noted that the compliance systems, disclosure and reporting requirements to investors under MFDA rules and those under NI 31-103 differ on numerous points. PMs have developed knowledge, infrastructure, testing, sophisticated client agreements, disclosure, and reporting to support the discretionary relationship. MFD Members would need to amend their policies and procedures in connection with exercising discretion. MFD Members would also be required to develop, implement, and oversee a policies and procedures manual akin to those of restricted PMs regulated by the CSA in order to undertake this activity.

PMAC believes that a level of CSA oversight would be necessary and appropriate. For example, an MFD Member registered as a restricted PM should be subject to audit by the Ontario Securities Commission (**OSC**) (or another CSA member) and be required to complete the OSC bi-annual Risk Assessment Questionnaire.

We further believe that the CSA and CIRO should explicitly confirm that all Approved Persons engaged in discretionary activity on a MFD Member's behalf will be required to be registered as either associate advising representatives (**AARs**) or advising representatives (**ARs**), or in the relevant ID Member categories that permit discretionary activity. The CSA has consistently – and we believe correctly – taken the position that high proficiency and relevant investment management experience standards are critical to protecting the capital markets and investors. Part 3 of NI 31-103 CP states that the education and experience required for registration of a representative of restricted PMs will be decided by the regulator on a case-by-case basis.

In order to maintain investor protection and market integrity, CIRO and CSA should codify their expectations regarding the appropriate education and relevant investment management experience expectations required to enlarge the scope of permitted activity for Approved Persons.

We respectfully submit that the current proficiency requirements for registration as a dealing representative (Approved Person) of an MFD Member are objectively considerably less stringent that those required for ARs and AARs (and the relevant ID Member registration categories). We believe that, at a bare minimum, additional proficiency must be required in order to ensure that qualified professionals are making discretionary decisions regarding the funds being held in the investment portfolios of Canadian investors.

Duty of Care

PMAC strongly believes that all registrants entrusted with managing client assets on a discretionary basis should owe those clients a fiduciary duty of care. We point to the wording in the *Securities Act* (Alberta)[1] which codifies a fiduciary duty in connection with discretionary management.

Moreover, PMAC believes that it is inappropriate to treat the fiduciary duty as a transactional duty.[2] The fiduciary duty is and ought to be a legal expectation that permeates the entire culture and operations of a registered firm for the good of investors. PMAC is of the view that Approved Persons exercising discretion must also be held to the same standard of care as ARs and AARs who manage client assets on a discretionary basis.

[1] Section 75.2 of the Securities Act (Alberta) provides:
Duty of care
75.2(1) Subject to subsections (2) and (3), a registrant shall deal fairly, honestly and in good faith with its clients.
(2) A registrant that manages the investment portfolio of a client through discretionary authority granted by the client shall *act fairly, honestly and in good faith toward the client and in the client's best interest*.
(3) Every investment fund manager shall (a) exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the investment fund, and (b) exercise the degree of care, diligence and skill that a reasonably prudent person or company would exercise in the circumstances. [*emphasis added*]

[2] This is a problem that U.S. regulators have been attempting to address for some time, whereby a registrant could effectively "change hats", from a fiduciary on certain transactions, back to owing a lower "suitability standard" to the same investor with respect to other transactions. The U.S. Department of Labor (DOL) has proposed a fiduciary duty that would apply to all registrants in the course of providing products or services for retirement accounts. The proposal is intended to fill an existing gap where not all advice is required to be provided in the investor's best interest. The proposed rules would be consistent with the Regulation Best Interest. The common fiduciary standard will include transactions that are not currently uniformly covered by fiduciary protections (for example when retirement assets are rolled over to investment vehicles that are not covered by a fiduciary obligation). This is a perplexing problem that CIRO and the CSA should neither create, nor cause investors to grapple with.

With that in mind, we ask CSA and CIRO to:

1. consider how the fiduciary duty would be imposed on MFD Members exercising discretion since that duty of care would be neither statutory (other than in four Canadian jurisdictions), regulatory, nor contractual and;

2. carefully consider whether it is appropriate from a policy perspective – or feasible from a firm, investor, and regulatory oversight perspective - to make the fiduciary duty a transaction-based duty of care that applies to discretionary trades in a client's account in certain circumstances.

It is not clear how a regulator, an investor, or a court would be able to parse out the portions of a portfolio in respect of which an investor should expect that his or her best interests were put ahead of those of the MFD Member. We question what outcome that would provide investors.

The U.S. Securities and Exchange Commission (**SEC**)'s Regulation Best Interest standard for broker-dealers contains a particularly telling interpretation of the "solely incidental" provision, noting that when a broker-dealer exercises discretion on behalf of a retail client, that broker-dealer has tripped the requirement to register as an investment adviser (the U.S. equivalent of a PM) under the Investment Advisers Act of 1940 (**Advisers Act**). For the SEC, discretion triggers the requirement to register as an investment adviser and to be subject to the terms of the Advisers Act. In addition to the numerous requirements under the Advisers Act, investment advisers owe a fiduciary duty to their investors, as the SEC has recently affirmed and clarified.

Furthermore, MFD Member client documentation would need to be repapered to allow clients to meaningfully consent to any discretionary management. MFD Member clients should have the same protections and agreements in place as clients of PMs, who have entered into contractual arrangements regarding a wide variety of critical matters related to discretionary management.

KYC, KYP, COI, RDI, and Suitability Obligations

The CSA have stated that know your client (KYC), know your product (KYP), conflicts of interest (COI), relationship disclosure information (RDI) and suitability determination obligations are:

> fundamental obligations of registrants toward their clients and are essential to investor protection. They are designed to work together throughout the client-registrant relationship, as an extension of the duty of registrants to deal fairly, honestly and in good faith with their clients.[3]

MFD Members would need to enhance their KYC, KYP, COI, RDI and suitability obligations in the context of a discretionary account. Given the centrality of these obligations to investor protection, we believe that further consideration should be given to whether certain enhanced requirements matching those under NI 31-103 regarding these fundamental duties should be codified in the context of any MFD Member discretionary authority. Procedures would need to be implemented to ensure that these duties are met, whether the account is held in a fund company's client name program or is in a dealer's in-house or third-party nominee program.

Potential for Regulatory Arbitrage

The following comments are directed at the members of the CSA: we have concerns that permitting discretionary management by MFD Members could lead to increased regulatory arbitrage, resulting in fewer firms registering with the CSA. We believe it is important to flag the overall trend PMAC members have noted towards IIROC registered firms registering discretionary managers.

The goal of achieving certain efficiencies in one realm needs to be weighed against the risk of regulatory arbitrage that results from approving measures at the self-regulatory organization (**SRO**) level making it less onerous and costly to become registered – and maintain registration - under an SRO, such as CIRO, than it is under the CSA, while being permitted to provide similar services to investors.

We view distinct registration categories as important ways to provide different services and approaches to investment management for Canadian investors. However, we strongly caution against creating back-door channels for providing discretionary investment management to these investors without comparable duties of care, proficiency, compliance, and regulatory oversight requirements. To do so

[3] See "Overview and scope of the Proposed Amendments" in CSA Notice and Request for Comment – Proposed Amendments to National Instrument 31-103 – Registration Requirement, Exemptions and Ongoing Registrant Obligations and to CP 31-103, Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms).

may provide incentives for firms and individuals to assess the regulatory landscape for the easiest route to performing discretionary asset management.

For this reason, we believe the CSA should consider whether any discretionary asset management, whether by CIRO member firms or those registered with the CSA, should be subject to direct CSA oversight and review. Similar to the approach taken in the U.S., as described above, we believe that this would contribute to more harmonized compliance standards, better investor protection and would avoid regulatory arbitrage.

PRACTICALITY

Lastly, PMAC raises the following questions about the practicality and ability of the CSA and CIRO to operationalize the provision of discretionary management by MFD Members:

- How practical it will be for MFD Members to evidence their Approved Persons' proficiency to be registered as restricted AARs and ARs without additional training / hiring and therefore, overall cost;
- The ability to impose a fiduciary duty on some, but not all transactions, in a client's account when an MFD Member is exercising discretion;
- How cooperative oversight of the implementation at each MFD Member by both the CSA and CIRO can be achieved without incurring additional and onerous registration, audit and/or reporting requirements; and
- How investor consent to discretionary authority can be obtained without repapering at least some client documentation, thereby increasing the compliance burden and cost.

CONCLUSION

We are pleased that CIRO is undertaking rule consolidation and believe that this project will contribute to harmonization, efficiency and improved investor experiences within ID and MFD Members. PMAC is cognizant that there are many opportunities in the asset management industry to revisit existing restrictions and to disrupt current practices to provide better service and outcomes to investors. We are supportive of exploring new possibilities and ways of delivering services to investors while reducing costs to firms and, ultimately, to investors. Cost savings and efficiency, however, cannot and should not come at the price of investor protection or at the risk of creating nebulous duties towards those investors.

We believe the questions and issues raised in our submission are important ones that merit further consideration and elaboration in order to ensure that a high level of

investor protection and confidence in our markets is maintained. We look forward to responding to any future proposals to change the rules with respect to discretionary management at MFD Member firms. In the meantime, we agree that the status quo should be maintained.

If you have any questions regarding the comments set out above, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Victoria Paris at (416) 802-4347.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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