

CSA finalizes client focused reforms to Canadian securities registration rule

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In this Update

- On October 3, 2019, the Canadian Securities Administrators (CSA) published [Reforms to Enhance the Client-Registrant Relationship \(Client Focused Reforms\)](#) [PDF], finalizing amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and its companion policy (the Amendments)
- The CSA expects that the Amendments will result in a new, higher standard of conduct across all categories for registered dealers and advisers and their representatives
- The Amendments will come into force across Canada on December 31, 2019, and will be phased in during a two-year transition period
- The Amendments do not carry forward certain controversial elements of the Proposals, such as new restrictions on referral arrangements and a highly prescriptive know-your-product (KYP) process, giving registrants more flexibility to implement the Client Focused Reforms in a manner appropriate for their businesses
- The Amendments have reinstated carve-outs from enhanced KYC and suitability requirements for registered firms dealing with permitted clients and permit suitability waivers to be obtained by advisers from permitted clients, other than individuals, in respect of managed accounts

Background

On October 3, 2019, the Canadian Securities Administrators (CSA) published [Reforms to Enhance the Client-Registrant Relationship \(Client Focused Reforms\)](#) [PDF] providing notice of amendments (the Amendments) to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103) and its companion policy (the Companion Policy). The Amendments are the outcome of a six-year public consultation process seeking to better align the interests of registered firms and individuals with the interests of their clients. The Amendments will require registrants to put clients first when discharging their know-your-client (KYC), know-your-product (KYP) and suitability obligations; address material conflicts of interest in the best interest of the client; and do more to clarify for clients what they should expect from their dealers and advisers.

Timing

Provided all ministerial approvals are obtained from CSA members, the Amendments will come into force across Canada on December 31, 2019, and will be phased in during a two-year transition period, with the Amendments relating to conflicts of interest and the associated relationship disclosure information provisions taking effect on December 31, 2020, and the remaining Amendments taking effect on December 31, 2021.

Summary of Amendments and key changes to Proposals

The CSA published proposed amendments to NI 31-103 and the Companion Policy for comment on June 21, 2018 (the Proposals), discussed in our Osler Update. The Amendments do not carry forward certain controversial elements of the Proposals, such as new restrictions on referral arrangements and a highly prescriptive KYP process, giving registrants more flexibility to implement the Client Focused Reforms in a manner appropriate for their businesses. Key changes to the Proposals reflected in the final Amendments are:

- **Referral Arrangements:** Proposals to cap referral payments, restrict the time period for referral arrangements to 36 months and prohibit the payment of referral fees to unregistered parties have not been carried forward in the Amendments. However, the Amendments maintain the broader definition of referral fee set out in the Proposals, which includes any “benefit provided [by a registered firm]...to or from another person or company” for the referral of a client. This definition is likely to capture arrangements that are not caught under the current definition, which is limited to arrangements in which a registrant agrees to “pay any form of compensation, direct or indirect, for the referral of a client.” The CSA also notes that enhanced standards for conflicts of interest included in the Client Focused Reforms will apply to referral arrangements.
- **Expanded KYC and suitability waiver for permitted clients:** The Amendments have reinstated carve-outs from enhanced KYC and suitability requirements for registered firms dealing with permitted clients (i.e., institutional clients) that waive these rights in writing, which had not been included in the Proposals. In addition, the Amendments permit suitability waivers to be obtained by advisers from permitted clients, other than individuals, in respect of managed accounts, which broadens the scope of permitted client suitability waivers available under NI 31-103.
- **Materiality threshold for conflicts of interest:** The Amendments implement the requirement for registrants to resolve conflicts of interest in the best interest of a client, however, the Amendments introduce a materiality threshold to the new requirements for firms to address, disclose or, in some cases, avoid conflicts of interest. The Companion Policy provides guidance regarding the CSA’s expectations for registered firms to address and document the resolution of material conflicts of interest relating to referral arrangements, sales practices, compensation arrangements and incentive practices. The Amendments do not carry forward the prohibition in the Proposals on a registrant to act as a power of attorney or trustee for clients.

- **Enhanced KYC:** The Amendments eliminate some of the prescriptive Companion Policy guidance regarding the KYC process which had been included in the Proposals, and clarify that the depth of inquiry a registrant must make with regard to a client will vary and should be tailored depending on the securities and services offered, the firm's business model and the nature of the client relationship. In addition, the Amendments do not carry forward the requirements in the Proposals for registrants to conduct a KYC update when they "reasonably ought to know" about a change, rather, a KYC update is triggered when the registrant becomes aware of a significant change. Minimum timeframes for KYC updates from the Proposals have carried forward in the Amendments: every 12 months for a managed account, within 12 months of recommending a trade for an exempt market dealer and every 36 months in any other case.
- **New KYP obligation:** The Amendments respond to industry feedback by omitting many of the prescriptive KYP requirements that had been set out in the Proposals, such as requirements for registered firms and/or individuals to: (i) conduct a market comparison of investment products they offer against competing products in the market; (ii) conduct a rigorous KYP analysis of securities transferred into a client's account with a registered firm (e.g., legacy securities); (iii) have a general knowledge of each type of security available to clients, and how those securities compare; and (iv) monitor and reassess securities offered to clients. Instead, the Amendments introduce Companion Policy guidance to assist registered firms and individuals to meet their KYP obligations to clients when considering legacy securities and recommends that registrants should understand the basis of a security's return and monitor securities for significant changes. The Companion Policy also notes that the enhanced KYP requirements are scalable, depending on the nature and complexity of the securities involved.
- **Suitability determination:** The Amendments do not carry forward Companion Policy guidance from the Proposals which stated: (i) that a registrant should inquire about a client's investments held elsewhere in order to inform the registrant's suitability determination; and (ii) the CSA's expectation for a registrant to recommend the lowest cost security available to the client absent a reasonable basis for determining that a higher cost security is better for the client. In addition, the Amendments have removed certain prescriptive suitability assessment factors from NI 31-103, and instead included these factors as Companion Policy guidance.
- **Publicly Available Information:** The proposed requirement for registered firms to make certain relationship disclosure information publicly available has not been carried forward in the Amendments.
- **Relationship disclosure information:** The Amendments do not carry forward the requirement in the Proposals for a registrant to explain to clients the impact on returns as a result of any restrictions on the products or services the firm will provide to a client, however, the Amendments maintain the new requirement for registered firms to disclose when they offer primarily proprietary products and whether there will be other limits on

the availability of products and services.

Further Client Focused Reforms

The Amendments do not address certain matters discussed in the Consultation Paper and the Proposals, such as proficiency standards, titles and designations, a statutory fiduciary duty applicable to advisers exercising discretionary authority and other reforms to the referral arrangement requirements. The CSA notes that it continues to work on these matters and expects to propose additional client focused reforms to address these matters.