Surging to 2021

BLG's 2020 Vision of the **Client Focused Reforms**

Through the Client Focused Reforms set out in the revisions to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that came into force on December 31, 2019, the CSA expect registrants to better align their interests with the interests of their clients. Registrants will be expected to put the interests of their clients first, particularly (but not solely) when managing conflicts of interest and making suitability determinations.

The new rules and CSA expectations regarding conflicts of interest and enhanced client disclosures will be effective on December 31, 2020, with the balance of the rule and policy changes becoming effective on December 31, 2021. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) are taking steps to further amend their rules and associated guidance within these time periods to conform to the Client Focused Reforms.

The CSA emphasize that their aim is to create a "new, higher standard of conduct" across all categories of registrants. It is clear that the CSA intend for the Client Focused Reforms to be transformational and give rise to real change in how registrants approach their interactions with clients. Compliance with the new expectations will be critical. The months ahead to December 31, 2020 and beyond to December 31, 2021 provide an excellent opportunity for registrants to reflect on – and improve – existing processes, controls and client interactions and disclosures.

We believe that all registrants will need to develop a project plan to identify and implement changes to client documentation, internal controls, training programs, compliance policies and procedures, compensation models, client services and product line-up, among other things. There is much to understand, consider and implement in ways that make sense for a firm and its clients. BLG would be pleased to be your external adviser to assist in your planning for, and implementation of, the Client Focused Reforms.

With BLG's 2020 Vision of the Client Focused Reforms, we can provide you with the full range of legal and advisory services you may need. Our services will initially emphasize the new rules and expectations coming into force in 2020, and we will develop other specific frameworks for the 2021 rules and expectations.

- **BLG's 2020 Conflicts Framework** will enable registrants to develop a compliance framework for identifying and managing conflicts in the best interests of their clients.
- **BLG's 2020 Client Disclosure and On-Boarding Framework** will enable registrants to develop enhanced client disclosure, including for the RDI, pre-trade disclosure and conflicts disclosure expected by December 31, 2020.
- **BLG's 2020 Training Programs Framework** will allow registrants to meet the training expectations for representatives, and also for executives, the board and compliance staff.

We have extensive experience and expertise in working with registrants on implementing new and enhanced regulatory requirements. We would be pleased to discuss with you how we can assist you in understanding the Client Focused Reforms and how they will affect your firm and its representatives.

Conflicts Framework

Through the Client Focused Reforms set out in the revisions to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that came into force on December 31, 2019, the CSA expect registrants to better align their interests with the interests of their clients. Registrants will be expected to put the interests of their clients first, particularly when managing conflicts of interest.

The new rules and CSA expectations regarding conflicts of interest will be effective on December 31, 2020. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) are taking steps to further amend their rules and associated guidance within this time period to conform to the Client Focused Reforms.

Compliance with the new expectations around identifying and managing conflicts of interest will be critical. The months ahead to December 31, 2020 provide an excellent opportunity for registrants to reflect on – and improve – existing processes, controls and client interactions and disclosures.

The Client Focused Reforms introduce a new standard for managing material conflicts of interest: conflicts must be addressed *in the best interest of the client*.

Registrants must:

- take reasonable steps to identify existing and reasonably foreseeable material conflicts of interest between a client and the firm or any individual acting on the firm's behalf
- address all material conflicts of interest in the best interest of the client
- avoid material conflicts of interest that cannot be otherwise addressed in the best interest of the client
- provide affected clients with written disclosure of material conflicts of interest at account opening or in a timely manner thereafter
- in the case of registered representatives – promptly report all material conflicts of interest to their sponsoring firm and refrain from any trading or advising activity in connection with a material conflict of interest unless (i) the conflict has been addressed in the best interest of the client, and (ii) the representative has received consent from their sponsoring firm to proceed with the activity.

A registrant will not satisfy the requirement to address material conflicts in the best interest of the client solely by providing disclosure to the client.

Investment fund managers of public funds remain subject to the conflicts regime in National Instrument 81-107 *Independent Review Committee for Investment Funds* and therefore are exempt from the conflicts rules in the Client Focused Reforms. We anticipate that the resolution of conflicts under the NI 81-107 regime will be coloured by the Client Focused Reforms and a coordinated approach will be key.

BLG's 2020 Conflicts Framework

We can assist registrants in developing a compliance framework for identifying and managing conflicts in the best interest of their clients. BLG's 2020 Conflicts Framework will allow registrants to:

- Define "conflicts of interest" in ways that will resonate with individuals working for the firm - including executives, representatives and operational and compliance staff. Conflicts of interest are not always obvious and all executives, representatives and staff must be able to understand when a conflict of interest may arise. Determining whether a material conflict exists is a context-specific exercise in which registrants should consider whether the conflict may be reasonably expected to affect the client's decisions and/or the registrant's decisions or recommendations in the circumstances.
- Identify existing conflicts of interest and determine whether these conflicts are being managed in the best interest of the client. BLG's 2020 Conflicts Framework identifies common conflicts of interest, which will allow a firm to determine if these specific conflicts are material to the firm.

Examples of conflicts of interest are provided by the CSA in the Companion Policy to NI 31-103 (as listed below), but these should not be taken as the only conflicts of interest that could apply to a firm.

  - Distribution of proprietary products
  - Accepting compensation from third parties for distributing certain securities
  - Referral arrangements
  - Fee-based accounts (in certain circumstances)
  - Internal compensation practices that could influence which securities and products are recommended to clients
  - Outside business activities of representatives, including acting as director or officer of another entity or being a shareholder of another entity.
- Understand what is meant by managing conflicts of interest in the best interest of the client and what mitigation techniques or controls can be used to ensure that clients' interests are prioritized over any other competing considerations. A firm may need to prohibit certain activities, if it cannot be certain that a conflict will be managed in the best interest of the client. The CSA's suggested controls for those conflicts listed in the Companion Policy to NI 31-103 must be carefully considered.
- Develop escalation practices that will be implemented internally for representatives and all staff to identify conflicts of interest and escalate them to internal decision makers who will determine how to address the conflict.
- Ensure that plain and clear written (and verbal) disclosure is given to clients about conflicts of interest and how they are managed, while ensuring that other controls exist to manage the conflict beyond disclosure.
- Develop a testing regime for the firm's conflicts management framework.
- Include regular CCO reporting of conflicts management to the firm's UDP, executive team and board of directors.
- Develop adequate processes for written records on how conflicts are identified, escalated and managed.
- Develop and carry out effective training programs for all executive, representatives, operational and compliance staff to ensure appropriate levels of understanding of conflicts and the firm's conflicts regime.
- Ensure that the firm's written compliance policies and procedures reflect the specific conflict management practices.
- For investment fund managers, ensure that the conflicts regime as it applies to management of their public funds is effective and remains compliant with NI 81-107 and fits with the conflicts regime expected by the Client Focused Reforms for any other business conducted within the firm.

Client Disclosure and On-Boarding Framework

Through the Client Focused Reforms set out in the revisions to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that came into force on December 31, 2019, the CSA expect registrants to better align their interests with the interests of their clients. Registrants will be expected to put the interests of their clients first, particularly (but not solely) when managing conflicts of interest and making suitability determinations.

Disclosure to clients remains a critical piece of the regulatory structure. New disclosure requirements come into force on December 31, 2020 - enhanced "relationship disclosure information" (RDI), expanded pre-trade disclosure and enhanced disclosure of conflicts of interest. The remaining disclosure related rules will become effective on December 31, 2021. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) are taking steps to further amend their rules and associated guidance within this time period to conform to the Client Focused Reforms.

Compliance with the new expectations will be critical. The months ahead to December 31, 2020 and beyond to December 31, 2021 provide an excellent opportunity for registrants to reflect on – and improve – existing client disclosures and the processes for client on-boarding, interactions and reporting.

Elements of enhanced RDI that will be required effective December 31, 2020, include:

- Expanded description of products and services offered, with a discussion on:
  - Any restrictions on the client's ability to liquidate or resell a security
  - Fund management expense fees or other ongoing fees the client may incur through investing in specific securities
  - Any limits on what products or services are available for accounts offered by the registrant, including whether the firm will "primarily or exclusively" offer proprietary products or whether there are any other limits on the availability of products or services.
- A description of any benefits (rather than just compensation) received, or expected to be received, in connection with the client's purchase or ownership of a security through the registrant.
- A statement that any investment action the registrant or its representatives take or recommend for a client must be suitable for the client and puts the client's interest first.
- A general explanation of the potential impact on a client's investment returns of operating charges, transaction charges, investment fund management expenses, and any other ongoing fees the client may incur, including the effect of compounding over time.

Enhanced pre-trade disclosure (to be provided at least verbally before a trade in a specific security is agreed to by the client) must include information about whether there are any expenses or other fees that the client may incur in connection with the security. This must include a discussion about management fees (MER) of an investment fund, for instance.

Disclosure of all material conflicts of interest must be provided to clients in a way that is "prominent, specific and written in plain language". The disclosure must include:

- The nature and extent of the conflict of interest
- The potential impact on and risk that the conflict may pose to the client
- How the conflict has been or will be addressed.

BLG's 2020 Client Disclosure and On-Boarding Framework

We can assist registrants in developing an approach to compliance with the disclosure requirements and expectations, in ways that are integrated with the registrant's on-boarding packages for new clients, its on-going interactions with clients and its reporting packages for existing clients.

The overarching principle is that registrants must give clients all information that a reasonable investor would consider important about the client's relationship with the registrant, including specific information on how the firm manages conflicts of interest. The CSA continue to focus on the need for plain language communications with clients.

BLG's 2020 Client Disclosure and On-Boarding Framework will allow registrants to:

- Ensure the RDI is comprehensive, covers all relevant (and required) information and is clearly and plainly written, with the use of technical terms and acronyms minimized.
- Ensure that plain and clear written (and verbal) disclosure is given to clients about conflicts of interest and how they are managed.
- Integrate RDI and conflicts disclosure with client on-boarding packages and on-going reporting.
- Document RDI updates and delivery to clients.
- Document pre-trade disclosure is provided to clients.
- Streamline client on-boarding packages, on-going reporting and website disclosure to ensure consistency with the Client Focused Reforms. This will include revised website disclosure, offering memoranda, subscription agreements, investment management agreements, client account agreements, account application forms, trade confirmations, account statements (among other documents).
- Include regular CCO reporting of disclosure to clients to the firm's UDP, executive team and board of directors.
- Develop and carry out effective training programs for all executive, representatives and operational and compliance staff to ensure appropriate levels of understanding about the purpose of and need for clear disclosure to clients.
- Ensure that the firm's written compliance policies and procedures reflect the new disclosure requirements.
- Ensure that the firm and its representatives will be ready for compliance with the new anti-misleading communication rules and expectations that will come into force on December 31, 2021 and the concepts behind these rules are integrated into the disclosure as much as possible in advance of 2021. These rules will prohibit registrants (individuals and firms) from holding themselves out in a manner that could reasonably be expected to deceive or mislead any person or company as to
  - the proficiency, experience, qualifications or category of registration of the registrant
  - the nature of the person's relationship, or potential relationship, with the registrant or
  - the products or services provided, or to be provided, by the registrant.

Restrictions on registered individuals using specific titles will also be effective on December 31, 2021. Registered individuals will not be able to use

- a title, designation, award, or recognition that is based partly or entirely on that registrant's sales activity or revenue generation
- a corporate officer title, such as President or Vice-President, unless the registrant's sponsoring firm has appointed that registrant to that corporate office pursuant to corporate law or
- a title or designation, unless that registrant's sponsoring firm has approved its use.

Training Programs Framework

Through the Client Focused Reforms set out in the revisions to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that came into force on December 31, 2019, the CSA expect registrants to better align their interests with the interests of their clients. Registrants will be expected to put the interests of their clients first, particularly (but not solely) when managing conflicts of interest and making suitability determinations.

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Training of representatives, executive and staff is a vital element of the Client Focused Reforms. A firm will be required to provide training to representatives (and we recommend also to executives and other personnel), on compliance with securities laws (and their respective roles in the compliance system). Training must be focused on the primary enhanced rules and CSA expectations associated with know-your-client (KYC), know-your-product (KYP), suitability assessments and identification and management of conflicts of interest. Notwithstanding that requirements for training will be phased in and not effective until December 31, 2021, it will be important to develop a training program and associated recordkeeping well in advance of that date.

A firm will be required to implement a training regime, assess it periodically and update it as necessary, including when the size and complexity of the firm's business changes, and when regulatory requirements and/or expectations change. Firms will also be required to document the training regime, including the assessments and updates.

Flexibility in designing, implementing and maintaining the training program is provided for in the Client Focused Reforms, however, the regulators expect certain specific areas to be covered, most notably with respect to conflicts of interests. Registrants will be expected to provide their registered individuals with information on

- How to identify existing and reasonably foreseeable material conflicts of interest between a registered individual and their client.
- How to address material conflicts of interest in the best interest of their client.
- How to put the client's interest first when making suitability determinations for their client.

Training obligations can be outsourced by registrants, but each firm will remain responsible for demonstrating that the training has met the regulatory requirements – and CSA expectations.

BLG's 2020 Training Programs Framework

We can assist registrants in developing a training program that is scaled to a registrant's business model, size and complexity to ensure that registered individuals, executive and other personnel understand their roles and responsibilities under the Client Focused Reforms and related securities laws.

BLG's 2020 Training Programs Framework will allow registrants to:

- Identify any gaps in the firm's compliance system that need particular focus in the training regime.
- Identify when a training regime needs updating and assist in updating it.
- Identify any gaps or deficiencies in a training regime.
- Ensure that registered individuals, executive, compliance and operational personnel receive appropriate and tailored training in all relevant areas.
- Develop methods of training that will be interesting, engaging and useful for registered individuals and others and that will be proportionate to the nature of the firm.
- Accurately document the training regime and the completion by each registered individual of training.
- Update the firm's compliance manual to ensure the training regime is codified.

We have training modules that we can tailor to specific firms, if firms decide to outsource all or part of their training program to BLG.

BLG's Investment Management and Registrant Regulation and Compliance Practice

Securities regulations and compliance expectations and standards are becoming increasingly complex on a global scale. Whether you are a portfolio manager, an investment fund manager or a dealer, you need advice and support from lawyers who not only understand your business and the laws that affect your business, but focus exclusively on registrants.

BLG is home to Canada's largest securities registrant regulation and compliance practice.

We are dedicated to understanding and resolving your regulatory and legal issues. We assist our registrant clients, both Canadian and international, with initial start-up, establishment of compliance and operational systems and ongoing advice and support.

We offer advice on structuring and offering funds, including hedge, private equity/venture capital and alternative funds, pursuant to private placements and public offerings to comply with applicable Canadian laws.

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