

Surging through 2021 to 2022

# BLG's Vision of the Client Focused Reforms

February 2021



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 and making suitability determinations.

The new rules and Canadian Securities Administrators (CSA) expectations regarding conflicts of interest and enhanced client disclosures with respect to conflicts of interest will become effective on June 30, 2021, 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) have either finalized, or will shortly finalize, amendments to their rules and associated guidance within these time periods to conform (often in identical ways) 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 leading up to June 30 and December 31, 2021 provide an opportunity for registrants to reflect and improve upon existing processes, controls and client interactions and disclosures.

All registrants will need to focus on identifying and implementing 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 for a firm and its clients. BLG would be pleased to be your external adviser to assist in your planning for, and implementing, the Client Focused Reforms.

With **BLG's Vision of the Client Focused Reforms** described in this booklet, we can provide you with the full range of legal and advisory services you may need. The following pages describe our tailored services for conflicts of interest, client disclosure and onboarding and training. We are developing frameworks for compliance with the new KYP and suitability assessments; the

latter once the SROs have completed their proposed guidance in respect of suitability. We would be pleased to discuss our views on compliance techniques to be put in place to ensure appropriate recognition of these enhanced expectations.

## Launch of BLG's CFR Communications Series - Surging through 2021 to 2022

Please keep an eye out for our upcoming monthly series of topical articles relating to issues that have arisen for firms seeking to implement the Client Focused Reforms. We will be hosting a series of webinars and podcasts to cover specific topics in accessible ways.

Our communications will be geared to busy legal, compliance and business personnel who need to know about the issues at hand in a time-efficient manner.

Below is a list of resources that may be helpful to you in understanding the lengthy journey to the Client Focused Reforms.

- [Now the Work Begins – “Client Focused” Registrant Reform Rules Published by the Canadian Securities Regulators – October 2019](#)
- [Client-focused registrant reform deadlines postponed due to COVID-19 – April 2020](#)
- [Client Focused Reforms – Frequently Asked Questions – Updated December 18, 2020 \(PDF\)](#)
- [IIROC Notice 20-0238 Client Focused Reforms – Proposed Rule Amendments for Public Comment – November 19, 2020 \(PDF\)](#)
- [IIROC Notice 20-0239 Client Focused Reforms – Housekeeping Rule Changes – November 19, 2020 \(PDF\)](#)
- [MFDA Bulletin #0843-P Client Focused Reforms \(CFR\) Amendments to NI 31-103 – Publication of Conforming Changes to MFDA Regulatory Instruments – November 19, 2020](#)

# Conflicts Compliance Services

The new rules and CSA expectations regarding conflicts of interest will be effective on June 30, 2021. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) have amended their rules and associated guidance to conform to the Client Focused Reforms, in substantially similar ways.

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.

Registered representatives must 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. However, disclosure of a firm's conflicts controls remains vital and updated disclosures are expected to be made available to existing clients by June 30, 2021 as well as provided to new clients opening accounts after that date.

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. A coordinated approach to conflicts for those registrants who manage public funds and carry on other business will be key.

## BLG's Conflicts Compliance Services

We can assist registrants in developing a compliance framework for identifying and managing conflicts in the best interest of their clients. BLG's Conflicts Compliance Services 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. We can assist you in identifying common conflicts of interest, which will allow you to determine if these specific conflicts are material to your firm.

Examples of conflicts of interest are provided by the CSA in the Companion Policy to NI 31-103 (as listed below); however, they 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; and

- 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, KYC and On-Boarding Compliance Services

Disclosure to clients remains a critical piece of the regulatory structure. “Know-your-client” (KYC) remains a pillar of the new regime, and significantly enhanced suitability expectations will apply starting January 1, 2022. New disclosure requirements regarding enhanced disclosure of conflicts of interest come into force on June 30.

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; and
- how the conflict has been or will be addressed.

It will be important to determine how this enhanced disclosure will be provided to existing clients on or before June 30, 2021.

The enhanced “relationship disclosure information” (RDI), expanded pre-trade disclosure and the other remaining disclosure related rules will become effective on December 31, 2021.

Compliance with the new expectations will be critical. The months leading up to June 30 and December 31, 2021 provide an excellent opportunity for registrants to reflect, and improve upon, existing client disclosures and the processes for client on-boarding, interactions and reporting.

Elements of enhanced RDI that will be required effective December 31, 2021 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; and
  - 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 their interest first.
- A general explanation of the potential impact on a client’s investment returns of operating charges, transaction charges, investment fund management expenses, as well as 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 the client agrees to a trade in a specific security) 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.

Firms also will want to focus on account opening documents, including questionnaires and application forms which collect KYC information. Subtle, but important enhancements have been made to the elements of KYC that are expected to be collected, and it will be important to determine how these relate to the new suitability enhancements and expectations.

## BLG’s Client Disclosure, KYC and On-Boarding Compliance Services

We can assist registrants in developing an approach to comply with the disclosure requirements and KYC 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 regarding 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.

In addition, suitability assessments must be related to the KYC information collected from clients and all recommendations and actions with respect to a client’s account must put the client’s interest first.

BLG's Client Disclosure, KYC and On-Boarding Compliance Services will allow registrants to:

- Ensure that plain and clear written disclosure is given to clients about conflicts of interest and how they are managed. Ensure that representatives understand how to explain the conflicts disclosures to clients and emphasize the importance of this information.
- Ensure the RDI is comprehensive, covers all relevant and required information and is written in plain and clear language, with the use of technical terms and acronyms minimized.
- 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 that is provided to clients.
- Ensure that the firm collects the appropriate KYC information so it can carry out the enhancements to the suitability assessments expected by the Client Focused Reforms. It will be important to review account opening questionnaires and application forms to ensure the correct information is collected and integrated with the new expectations for suitability assessments.
- 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 about KYC and suitability enhancements, along with disclosure changes.
- 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, as well as the purpose of KYC collection and suitability assessments.

- Ensure that the firm's written compliance policies and procedures reflect the new disclosure, KYC and suitability assessment 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 2022. 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 Compliance Services

Training of representatives, executives and staff is a vital element of the Client Focused Reforms. A firm will be required to provide training to representatives on compliance with securities laws and their respective roles in the compliance system. We also recommend this be extended to executives and other personnel. 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 record keeping 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 interest. 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; and
- 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 Training Programs Compliance Services

BLG 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 Training Programs Compliance Services 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;
- Ensure that change management principles are taken into account with training, with emphasis on what has changed and why change is important;
- 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; and
- 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 they decide to outsource all or part of their training program to BLG.

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## 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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## Surging through 2021 to 2022 – BLG's Vision of the Client Focused Reforms

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

their impact on your firm and its representatives. Please contact your lawyer in BLG's Investment Management Group or any of the contacts below.

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## BLG Registration Rules Book (April 2020 edition)

Our BLG Registration Rules Book, which incorporates the most commonly used national and multilateral instruments and policies affecting registered firms and individuals, has been updated to include the changes made by the Client Focused Reforms. You can view a copy of our [April 2020 Rules Book here](#).