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RE: IIROC Notice GN-3400-21-004 Know-your-client and suitability determination for retail clients

The Investment Industry Association of Canada (the “IIAC”) appreciates the opportunity to provide comments on the Proposed Guidance for Know-your-client and suitability determination for retail clients (the “Proposed Guidance”). The IIAC has previously submitted comments (the “IIAC Submission”) on January 22, 2021, on IIROC’s Client Focused Reforms (“CFRs”) Proposed Rule Amendments (“IIROC’s Proposed CFR Rules”), to which some of our comments on the Proposed Guidance refers.

The IIAC welcomes IIROC’s recognition that while the Proposed Guidance sets out some acceptable methods to comply with KYC and suitability determination obligations, IIROC states these may not be the only acceptable methods and dealers may use alternative methods. We find the statement that IIROC encourages dealers to adopt a risk-based approach when setting internal compliance procedures helpful as dealers develop their policies and procedures to comply with the requirements.

Further, IIROC sets out that, “Dealers have various means they can use to meet their obligations under the IIROC Rules, and not all of the issues discussed in this Guidance will be applicable to every Dealer.”

IIROC acknowledges elsewhere in the Proposed Guidance that a “one-size-fits all” approach to requirements is not appropriate and that dealers have the flexibility to determine how best to satisfy regulatory requirements.

In addition, we appreciate IIROC emphasizing that when reviewing suitability determinations, not only will any review consider what a reasonable registrant with a similar business model would have done in the same circumstances, but that there could be several decisions or recommendations that a registrant could reasonably conclude are suitable and put the client’s interests first. There is no one “best” decision or recommendation.

We agree that registered individuals should make their suitability determinations based on the information available to them at the time. We appreciate IIROC’s review of suitability will be based on what a reasonable registered individual with a similar business model would have done under the same circumstances and that IIROC will not review whether the suitability determination has been met based on events subsequent to the determination by the registered individual or dealer.

We believe it is of paramount importance to consider the Proposed Guidance through these principles given the wide variation in dealers' business models, client profiles and products and services offered.

Outlined below are our issues and concerns regarding aspects of IIROC's Proposed CFR Rules and the Proposed Guidance where we believe additional clarification to be beneficial or where differences from the CSA representations should be harmonized.

Know-your-client

2.02.02 Client identification

In IIROC Notice 19-0145, IIROC staff indicated that identification methods under anti-money laundering ("AML") regulatory obligations were acceptable methods that allow dealers to form a reasonable belief they know the identity of an individual. We trust that AML identification methods continue to be one of the acceptable methods to satisfy client identification requirements in clause 3202(1)(i) and sections 3203 through 3206 of IIROC's Proposed CFR Rules.

2.02.06 Creditworthiness of the client

The Proposed Guidance states that dealers must collect information to assess creditworthiness and that generally includes information relating to the client's financial circumstances. In accordance with section 2.02.05 of the Proposed Guidance, the depth of inquiries made and information collected/maintained varies with the services offered by the dealer. With respect to OEO dealers in particular, we are of the view that the principle set out in section 2.02.05 should be specifically referred to and applied in the Proposed Guidance. This is aligned with section 2.04, which states that OEO dealers are only expected to collect *certain* financial circumstances data elements, *as needed* according to their business model.

2.03.01 Client's personal circumstances

The Proposed Guidance appears to add a new requirement for OEO dealers to collect information about the client's "personal circumstances" that includes, among others, the number of dependents. In clause 3208(1)(i) of IIROC's Proposed CFR Rules, OEO dealers are exempt from collecting personal circumstances information. Section 2.02.01 of the Proposed Guidance differentiates between information needed to be collected to learn the "essential facts" and information collected related to the suitability determination obligation. However, despite this exemption in IIROC's Proposed CFR Rules, and language in section 2.02.01, section 2.03.01 of the Proposed Guidance indicates that personal circumstances information is considered "essential facts" relative to the client, such that all dealers are required to collect it. Further, section 2.04 of the Proposed Guidance indicates that for OEO accounts, dealers must collect certain personal circumstances information set out in paragraphs 3202(1)(iii)(a)(I) and (II) to meet AML requirements and to learn the "essential facts" of a client; however, not all the personal circumstances listed, including the number of dependents is collected under AML regulatory obligations, and as previously noted, OEO dealers were exempt from collecting information pursuant to clause 3202(1)(iii).

As a result, we are of the view that section 2.03.01 of the Proposed Guidance should be revised to limit essential facts to those based on clauses 3202(1)(i) (establish the identity of a client) and 3202(1)(ii) (established whether the client is an insider). Section 2.04 should also be revised to reflect these changes to what is required to be collected by all dealers.

2.03.07 Detail of KYC information to be collected for suitability determination purposes

The IIAC appreciates the flexibility provided by the Proposed Guidance with respect to the level of detail dealers are required to collect for KYC based on their business model, relationship with clients and securities and services offered.

2.04 Is the KYC obligation the same for all accounts?

The Proposed Guidance clarifies that the requirement to determine a client's investment needs and objectives and risk profile do not apply to OEO accounts. Consistent with existing IROC Dealer Member Rule 1300.1(t) and Proposed CFR Rule 3208(1)(i), it should also be clarified that the requirements to determine a client's investment knowledge, liquidity needs, and investment time horizon are not applicable to OEO accounts.

2.06.01 How does the client confirm the accuracy of this information?

The IIAC appreciates IROC's clarification that dealers may evidence confirmation of the accuracy of KYC information in a variety of ways, including use of a signature, or through notes in the client's file. With respect to OEO dealers, we request clarification that there is no further requirement to verify any change to client information with the client in writing, if the client provided their KYC information in a manual or digital form with their signature (handwritten, electronic or digital signature) or provided verbal instructions to update their KYC information and provided confirmation of their updated KYC information during a recorded telephone.

2.11.01 Keeping KYC information current

This section appears to be imposing new KYC requirements for OEO accounts and carrying brokers. The Proposed Guidance does not differentiate between types of dealers when discussing updating KYC information. OEO dealers and carrying brokers are exempt from the requirements in subsection 3209(4) to review the information collected under clause 3202(1)(iii) based on specific frequencies. We would appreciate clarification in the Proposed Guidance that statements such as "we consider information to be current if it is sufficiently up-to-date to support a suitability determination" as not applicable to OEO dealers and carrying brokers. OEO dealers may determine the method and frequency to ensure certain client KYC information is sufficiently up-to-date as per their business model.

2.12 Is there anything that should not be done as part of the collection and maintenance of KYC information?

The IIAC understands the potential issues related to pre-population of questionnaires with KYC information for new clients. However, for existing clients, we believe it is reasonable for a registered individual to use the existing questionnaire with the KYC information the client previously populated or confirmed, as a starting point for KYC review discussions. This would improve the client experience by offering this convenience. However, this in no way would replace the continued importance of a meaningful conversation between the advisor and the client and the client's confirmation of the KYC. We request that the language in section 2.12 be revised to specify that dealers and registered individuals should not pre-populate questionnaires before interacting with a *new* client.

We support the client protection objectives behind the statement that a dealer or registered individual should not mischaracterize a client's KYC information to validate an otherwise unsuitable investment recommendation. The IIAC is concerned, however, that appropriate KYC updates showing increased risk tolerances in connection with suitable recommendations, may be unintentionally captured by the language in this section. We recommend inclusion of language in the Proposed Guidance to recognize KYC updates of risk tolerance can be appropriate when completed in connection with a suitable investment action.

Suitability

3.01.04 Account portfolio of investments approach to suitability

The IIAC is pleased to see that the Proposed Guidance is in alignment with Companion Policy 31-103 ("31-103CP") with respect to the portfolio approach to suitability. In the IIAC Submission, we noted that IROC's proposed subsection 3402(4) appeared to be broader than section 13.3 of National Instrument 31-103 ("NI 31-103"), and 31-103CP, which limited portfolio suitability assessment to concentration and liquidity. The IIAC is hopeful that the final version of IROC's Proposed CFR Rules will similarly be amended, to avoid potential confusion for dealers as to the requirements.

As pointed out in the IIAC Submission, the term “investment portfolio” used in subsection 3402(4) of IIROC’s Proposed CFR Rules is not defined and could imply a multiple account suitability determination. We recommend consistency with the term used in the Proposed Guidance i.e. “account portfolio of investments”.

With respect to accounts held outside the firm, the Proposed Guidance in this section should be more fully harmonized with section 3.06 of the Proposed Guidance and the CSA’s CFR Implementation Committee FAQ (updated March 31, 2021).

3.02.01 What should the Registered Individual consider?

The Proposed Guidance states (emphasis added):

When recommending a security to a client in an advisory account that is suitable for the client and puts the client’s interest first, a Registered Individual should *disclose any material negative and positive factors* involved in the transaction to the client to assist the client in making an informed decision.

We request to have additional language inserted to this section recognizing that the depth of disclosure of material negative and positive factors will vary with the dealers’ business models, client profiles and products and services offered.

Registered individuals should be permitted to exercise their professional judgement to determine the extent of the disclosure required when recommending a security based upon several factors such as the client’s investment knowledge and experience, and the nature of the security. For example, there may be a greater need when it comes to less knowledgeable or experienced clients and complex and/or novel products.

3.03.01 What is the account appropriateness obligation?

IIROC Guidance Notice 18-0076 and clause 3211(2)(i) of the IIROC’s Proposed CFR Rules are clear that OEO dealers are not required to assess the appropriateness of the scope of products and services; however, the manner in which the Proposed Guidance is drafted appears to suggest that OEO firms are required to do so. We request that the language in this section be revised to clearly state that OEO dealers are not required to assess the appropriateness of the scope of products and services.

3.04.04 Reassessing suitability

As we noted in the IIAC Submission, we believe that subsections 3402(3) and 3403(4) of IIROC’s Proposed CFR Rules unnecessarily complicate how firms are to conduct suitability determinations and should be removed. 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.

If these sections are not removed in their entirety, we support an exemption for OEO dealers from clauses 3402(3)(i) and 3403(4)(i). The IIAC believes that it is problematic to impose ongoing suitability determination requirements on OEO dealers. 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 dealers 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.

3.05.01 Conditions for assessing suitability be assessed on a combined basis for multiple accounts

The IIAC is of the view that it is overly restrictive to require a client to be the same individual for all accounts in order to conduct suitability on a combined basis. Further, the proposed restriction directly conflicts with the view expressed by the CSA and IIROC, in the CSA’s CFR Implementation Committee FAQ (updated March 31, 2021) in response 62. The FAQ states that (emphasis added):

We note that where registered firms choose to offer “householding” for suitability determination purposes and a client chooses to have suitability assessed on this basis (*and each of the clients in the household agrees*)

...

Thus, the CSA permits multiple clients to consent to having a suitability determination conducted on a “householding” basis.

Householding may be a preferred client service. The IIROC and Accenture Study, *Enabling the Evolution of Advice*, notes that clients are looking for an approach that not only supports their individual financial objectives and life goals, but one that considers the financial objectives of the entire family, or “household”. The restrictive language in the Proposed Guidance should be removed to allow dealers and registered individuals to continue to offer services to accommodate client needs. This section should be updated to be harmonized with the CSA criteria.

3.07 What are the obligations when a client has accounts in separate business lines at the same Dealer?

The CSA’s FAQ outlined their expectations for dealers with respect to a portfolio approach to concentration and liquidity factors in suitability determinations. The following language in the FAQ response 54 would be particularly helpful to contextualize the requirements:

For example, depending on the nature of the client-registrant relationship and the services and products offered, it may be appropriate for some securities in a client’s accounts at the firm to be excluded or discounted when assessing liquidity or concentration levels as factors when making suitability determinations for the client going forward. That assessment must be consistent with the client’s expectations and includes the exercise of professional judgment by the registrant in determining that the client has a level of investment knowledge sufficient to support the conclusion that the client understands, and does not need, the benefit of having those factors considered across all of their accounts at the firm. In such cases, the registrant should (i) disclose in writing to the client that liquidity or concentration level factors across accounts will not be considered by the registrant in the scope of suitability determinations that the client will receive and (ii) document the basis upon which the registrant reached that conclusion. It may also be advisable to include the client’s express acknowledgment of their expectations in this regard.

This information should be incorporated into the Proposed Guidance, as currently only a portion of this section of the FAQ is reflected in the Proposed Guidance.

3.10 Is there anything that Dealers and Registered Individuals should not do?

The Proposed Guidance states that dealers and registered individuals should not “fail to document their suitability determination analysis.” While we agree that dealers and registered individuals are required to complete a suitability determination analysis, we do not agree that such analysis should always be documented. Section 3804 of IIROC’s Proposed CFR Rules requires a dealer to maintain current records to demonstrate compliance with suitability requirements. The rule is at the dealer level, not at the individual registrant level. The dealer could satisfy this requirement in a variety of ways including: the retention of KYC forms, records of tier-1 and tier-2 supervision being completed with respect to account holdings, etc.

The Proposed Guidance may be read to suggest that each time a registered individual recommends a security for a client’s account, they are required to document the suitability analysis. Registered individuals should be permitted to exercise their professional judgement to determine when documentation is necessary and the extent of the documentation depending on such factors as the client’s investment knowledge or experience, the nature of their relationship with the client and the nature of the securities. Prescribing documentation in all instances is not reasonable and adds an undue burden.

Minor Drafting Revision

The IIAC wishes to point out that there is a minor error in footnote 31 on page 26 of the Proposed Guidance. Reference to sub-clauses 3216(5)(i)(a) and 3216(5)(i)(h), should instead refer to sub-clauses 3216(5)(**ii**)(a) and 3216(5)(**ii**)(h).

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

Yours sincerely,

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