

Regulatory Update

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AGENDA

- Alternative Mutual Funds
- Client Focused Reforms
- Embedded Fees Proposals

ALTERNATIVE MUTUAL FUNDS

- New Alternative Mutual Funds regime in force January 3, 2019
- Will offer hedge fund strategies to NI 81-102 retail investors
- Entirely new asset class
- A few funds already available through exemptive relief
- Based on current experience, it is likely that most AMFs will be purchased by fund of funds rather than retail clients
 - partly due to proficiency requirements as well as KYP and suitability considerations

ALTERNATIVE MUTUAL FUNDS (CON'T)

- Risk ratings will be interesting to watch
- CIFSC waiting to see products which come to market to decide fund classification categories
- Regulators working on some accounting issues relating to securities lending

ALTERNATIVE MUTUAL FUNDS (CON'T)

Operational Concerns?

- Every fund launch includes a Product Type
- There exists a Product Type of “Alternative Funds”
- Do distributors need a new Product Type?

CLIENT FOCUSED REFORMS

- Published for comment June 2018; comments closed Sept. 2018
- Proposed changes in 7 main areas:
 1. Know your client requirements
 2. Know your product requirements
 3. Suitability
 4. Conflicts of interest
 5. Public disclosure
 6. Referral arrangements
 7. Use of titles

CLIENT FOCUSED REFORMS (CON'T)

- **Dealer firms will be most impacted by the proposed CFRs**
 - Revisions to policies, procedures, compliance programs and training for KYC, KYP (firm and individual level), suitability, COIs
 - Will require systems changes in some areas as well ie. COIs
- **IFIC has outlined a number of overarching concerns which must be addressed in the final rule:**
 - Preserve investor choice—KYP requirements might result in shortened shelves
 - Modify the current overemphasis in the CFRs on cost as the primary consideration when making a recommendation
 - Ensure that the guidance in the Companion Policy is guidance only and, in audits, acknowledge the registrant's ability to comply with the rule requirements in a manner best suited to the registrant and its business model
 - Ensure regulatory consistency, both with SRO rules and in using the same terminology within the rule and the Companion Policy.

CLIENT FOCUSED REFORMS (CON'T)

- IFIC has proposed refinements to a number of the requirements, in particular to align more closely with existing SRO rules
- IFIC has suggested a 3 year transition period once the rule is finalized to allow for revisions to policies & procedures, systems and training.

CLIENT FOCUSED REFORMS (CON'T)

Operational Concerns?

- Are there new product feature fund data points that distributors require for KYP review requirements? For example:
 - Liquidity indicator
 - Time horizon indicator
 - Performance history
 - MER
 - Embedded fees
- Should these be included in Fundserv file or from a third-party?

EMBEDDED FEES PROPOSALS

Embedded Fees Proposals

- Published for comment September 13, 2018; comments due December 13, 2018
- 2 separate proposals: The DSC Proposal and the OEO Proposal
- Same day they were published, Ontario Minister of Finance indicated he did not support the DSC Proposal; ministerial approval is required before any new rules under the *Securities Act* come into force

EMBEDDED FEES PROPOSALS – DSC PROPOSAL

DSC Proposal

- Would prohibit sale of mutual funds using the DSC payment option
 - CSA asking whether existing DSC redemption schedules should be permitted to run out
 - CSA asking if there is a risk of regulatory arbitrage and what specific measures or initiatives regulators should take to mitigate the risk
- IFIC will maintain its public position that investors should have choice in the type of products they purchase and the purchase options available
 - Greater transparency around the DSC redemption schedule should be the goal
 - Compliance with current supervision, suitability and disclosure requirements should be enforced
 - CFR requirements re KYC, KYP and suitability will enhance the existing framework for assessing whether and when to recommend a purchase using the DSC option

EMBEDDED FEES PROPOSALS – DSC PROPOSAL (CON'T)

Operational Concerns?

- If the DSC option is banned, should Fundserv reject DSC or Low Load purchases for the industry?

EMBEDDED FEES PROPOSALS – OEO PROPOSAL

OEO Proposal

- Will prohibit the payment of any trailing commission in a situation where advice is not provided
 - Generally will be on Order Execution Only platforms or for permitted clients who have waived a suitability determination
 - How will fund manufacturers comply with the prohibition on paying trailing commission where no suitability determination—no clear line of sight
 - As between the dealer and the manufacturer, who should be responsible for making the switch to the appropriate series/
 - How will transfers in be handled?

EMBEDDED FEES PROPOSAL – OEO PROPOSAL (CON'T)

Operational Concerns?

- v29 in June 2019 includes Discount account identifier
- Distributors will send NFU file to update manufacturer systems
- Distributors should include this indicator when sending new account set ups to manufacturers