

August 2, 2019

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SENT VIA EMAIL

Dear Ms. Ward and Ms. Hamilton:

**Re: Proposed Amendments to MFDA Rule 2.3.1(b) (Discretionary Trading)**

On behalf of Advocis, The Financial Advisors Association of Canada, we are pleased to provide our comments in regards to the Proposed Amendments to MFDA Rule 2.3.1(b) (Discretionary Trading).

## **1. ABOUT ADVOCIS**

Advocis is the association of choice for financial advisors and planners. With more than 13,000 members across the country, Advocis is the definitive voice of the profession, advocating for professionalism and consumer protection. Our members are provincially licensed to sell life, health and accident and sickness insurance, as well as by provincial securities commissions as registrants for the sale of mutual funds or other securities. Members of Advocis are primarily owners and operators of their own small businesses, creating thousands of jobs across Canada. Advocis members provide advice in several key areas, including estate and retirement planning, wealth management, risk management, tax planning, employee benefits, critical illness and disability insurance.

Professional financial advisors and planners are critical to the ongoing success of the economy, helping consumers to make sound financial decisions that ultimately lead to greater financial



stability and independence both for the consumer and the country. No one spends more time with consumers than advisors and planners, educating them about financial matters and helping them to reach their financial goals. Advocis works with decision-makers and the public, stressing the value of financial advice and striving for an environment in which all Canadians have access to the advice they need.

## **2. OUR COMMENTS**

Advocis commends the MFDA for listening to industry feedback and acting to reduce regulatory burden through the proposed amendments, which would allow Members to engage in very limited discretionary trading in respect of dealer-administered mutual fund model portfolios. In our view, the proposed amendments are an appropriate method to reduce unnecessary costs and administrative burden for Members, with the added benefit of reducing consumer confusion and enhancing investor protection.

### **i. Enabling efficient customer service and leveraging technology**

By nature, model portfolio programs involve a significant number of clients with investments in the same funds. In the event of a sudden shift of market conditions or a performance issue with a given fund, Members may need to seek and obtain consent from hundreds of clients prior to making changes that would limit losses or otherwise provide the highest level of service to clients. This expectation may be reasonable when circumstances require more significant discretionary trading within model portfolios, but in our view, clients may be best served when small changes such as those contemplated within the proposed amendments can be made swiftly and simultaneously across affected accounts.

The ability to effectively make these limited discretionary trades at scale also provides an opportunity for Members to more effectively leverage algorithms, artificial intelligence and other advances in technology. As technology enhances the ability to detect and respond to changes in a fund's anticipated performance and overall shifts in the market, Members and their clients benefit from having the regulatory flexibility to make small but necessary changes to funds within the model portfolio quickly and at scale. This benefit may be particularly relevant for Members who sell ETFs that meet the definition of mutual funds.

### **ii. Reducing regulatory and financial burdens while enhancing consumer protection**

As described in the notice accompanying the proposed amendments, the current rule prevents Members from engaging in any discretionary trading, including direct fund substitutions and limited changes to portfolio asset allocations. A Member seeking to provide discretionary trading services must either establish a separate legal entity as a portfolio manager registrant or must engage the services of an external portfolio manager to act on the Member's behalf. In our view, the additional expense and administrative burden required by these options are



excessive for the limited discretionary trading involved in fund substitutions and limited asset reallocation.

The involvement of a separate or external portfolio manager adds an extra level of complexity for investors. Regulatory requirements and obligations to clients are shared between the Member and the portfolio manager, increasing the potential for disputes about who is responsible and where liability rests in the event of a client loss or complaint. While this may be an appropriate division of risk and responsibility for clients with accounts requiring more extensive discretionary trading, we believe that it introduces an unnecessary level of confusion for limited discretionary trading within model portfolios. By allowing appropriately qualified Members to act as portfolio managers in the limited circumstances contemplated, regulatory obligations rest with one party.

Notably, the proposed amendments would require any Member seeking to provide limited discretionary trading services to register as a portfolio manager or obtain exemptive relief from a provincial securities regulator. The requirements to become a registrant or the decision to grant exemptive relief rests exclusively with the relevant securities regulator. In our opinion, this is an appropriate requirement. Any discretionary trading will continue to be held to a consistent standard of care, whether the Member is acting as the portfolio manager or has engaged the services of an external portfolio manager.

### iii. Concerns with respect to proprietary products

While we believe that the proposed amendments are fully appropriate as drafted, we note that there are greater investor protection risks present where the pre-established parameters of the model portfolio permit Members to directly make fund substitutions from different fund companies. Specifically, where independent, third-party products are substituted with a proprietary product, firms may have internal incentives and compensation practices that give rise to potential conflicts of interest<sup>1</sup>. Although portfolio managers are expected to act in a client's best interest, this standard may be more difficult to apply and to audit when dealing with proprietary products.

With many Members having either shared or direct ownership in portfolio management companies, we are concerned that discretionary trading in model portfolios could result in some Members acting to capture a larger market share of assets within proprietary funds. We believe that these risks could be addressed through required disclosure and appropriate oversight, including targeted reviews of discretionary trading activity.

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<sup>1</sup> CSA Staff Notice, *33-318 Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*, December 15, 2016. Available at: [https://www.osc.gov.on.ca/documents/en/Securities-Category3/csa\\_20161215\\_33-318\\_incentives.pdf](https://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20161215_33-318_incentives.pdf)



### 3. CONCLUSIONS AND NEXT STEPS

Advocis supports the MFDA's focus on regulatory burden reduction. We are in favour of the proposed amendments and are encouraged by the MFDA's attention to Member recommendations. We feel that the proposed amendments are practical, cost-effective and will provide enhanced service and investor protection for Canadian investors.

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We look forward to working with the MFDA as it works to reduce regulatory burden within the mutual fund industry. Should you have any questions, please do not hesitate to contact the undersigned, or Ed Skwarek, Vice President, Legal & Regulatory Affairs at 416-342-9837 or [eskwarek@advocis.ca](mailto:eskwarek@advocis.ca).

Sincerely,

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