

# Client Focused Reforms: KYC, KYP and Suitability Sweep - Findings from ASC Reviews

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## Today's agenda



#### **KNOW YOUR CLIENT (KYC)**

- Determination of risk profile
- Collection of financial circumstances information
- Keeping information current

#### **KNOW YOUR PRODUCT (KYP)**

- Firm assessments and approvals
- Registered individual obligations
- Monitoring for significant changes in securities
- Transfers in and client directed trades

#### **SUITABILITY**

- Suitability determination supporting documentation
- Impact on client's account / portfolio concentration and liquidity
- Impact of costs
- Reasonable range of alternative actions
- Client directed trades

# **KYC** – Determination of risk profile



#### Issues

- No change in the process for collecting risk information post-CFRs.
- No confirmation of risk profile by client.

#### Guidance

 Document and confirm assessment of both risk tolerance and risk capacity and how risk profile was determined.



# **KYC – Collection of financial circumstances** information

#### Issues

- Liquidity needs not collected.
- No or inadequate collection of net financial assets, net worth, and income.
- No breakdown of financial assets.

#### Guidance

• Comprehensive information is needed for registrants to have an accurate understanding of their clients' financial circumstances.

# **KYC** – Keeping information current



#### Issues

- Information not reviewed and updated at required minimum frequency.
- Inadequate documentation of periodic reviews and updates.
- No client confirmation of changes.

- Depth of review for each element depends on circumstances such as degree of changes and time since last update.
- Maintain evidence of steps taken to contact clients and make updates.

# **KYP – Firm assessments and approvals**



#### Issues

- Limited or no documentation for assessment of related or connected issuers.
- Insufficient evidence of elements supporting approval.

- Assessment should align with business model and the types and complexity of securities and products offered to clients.
- Firms can tailor and delegate functions across the organization based on their business model.
- Document assessment process and recommendations supporting the approval.

# **KYP** – Registered individual obligations



#### Issues

No assessment documented for model portfolios.

- Reasonable steps to fully understand securities vary depending on complexity, risk of securities and duties at the firm.
- Firms should provide materials and provide training as necessary.



# **KYP – Monitoring for significant changes in securities**

#### Issues

No process to monitor or no evidence of monitoring.

- Define what constitutes a significant change based on the types and complexity of securities and business model.
- Implement a process for monitoring for significant changes and document the oversight results.

#### **KYP – Transfers in and client directed trades**



#### Issues

- No assessment performed for transferred in securities and client directed trades – or not performed within a reasonable time.
- Excluding these securities from processes.

#### Guidance

 KYP assessment applies to all transferred-in securities, but depth of assessment depends on the circumstances.



# Suitability – Suitability determination supporting documentation

#### Issues

- Inadequate process for model portfolios.
- Limited documentation of assessment of suitability factors.

#### Guidance

 Documentation for the assessment of each factor depends on its relevancy to the suitability determination.



# Suitability – Impact on client's account/portfolio concentration and liquidity

#### Issues

- Not establishing and applying appropriate concentration and liquidity controls including across multiple client accounts.
- Insufficient financial circumstances KYC information to assess a client's concentration in exempt market securities.

#### Guidance

• Establish appropriate controls in place to calculate, monitor and manage concentration in a client's account and across a client's portfolio at the firm.

# Suitability – Impact of costs



#### Issues

 Inadequate documentation of consideration of costs when assessing securities with comparable alternatives.

#### Guidance

 Consider all relevant direct and indirect costs, fees, commissions and charges and assess those costs against the costs of other investment options available through the firm.





#### Issues

- A reasonable range of alternatives was not considered when:
  - selecting securities to be included in model portfolios;
  - selecting model portfolios for clients.

- Assessment can be centralized for certain business models.
- Requirement applies in respect of all securities approved by the firm and depends on business model.

# **Suitability – Client directed trades**



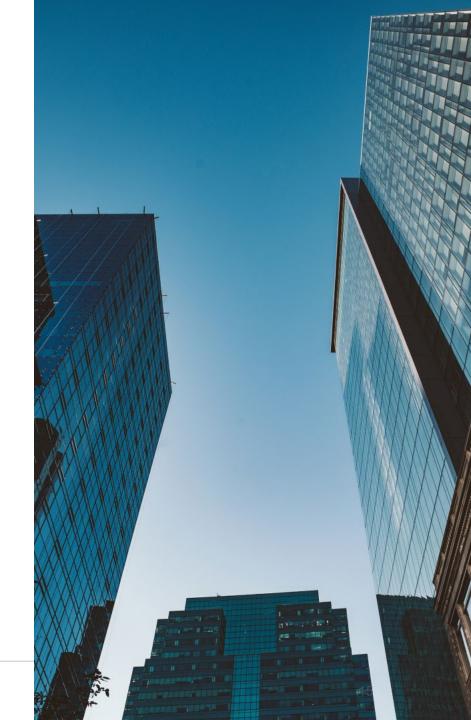
#### Issues

- No documentation to evidence the determination and alternative action recommendation.
- Inadequate consideration of factors for the proposed investment action.

#### Guidance

• First determine the suitability of the proposed investment action and advise client of recommendation prior to accepting client instructions.

- CSA Staff Notice to be published soon.
- CFR Implementation Committee FAQs: <u>https://www.securities-administrators.ca/csa-activities/client-focused-reforms/frequently-asked-questions-cfr/.</u>



## **Contact us**





# Findings from recent ASC compliance reviews

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# **Topics**



- Know your client (KYC)
- Know your product (KYP)
- Suitability
- Disclosure information
- Conflicts of interest
- Client reporting

- Marketing
- Policies and procedures
- Referral arrangements
- Insurance
- Fund and trust accounting

# **Know your client**



- Inadequate collection of KYC information:
  - > Establishing if a client is a domestic and foreign politically exposed person.
  - Confirming and collecting sufficient information on the client's personal and financial circumstances.
  - Collecting and updating a client's trusted contact person information.
- KYC forms not signed by the advising representative.

# **Know your product**



- KYP assessment conducted does not consider all the relevant aspects or elements of the security.
- No KYP assessment conducted for proprietary products.

## **Suitability**



- Suitability determination does not:
  - consider all the KYC information;
  - > assess the impact of concentration and liquidity on the client's account or portfolio.
- Client's portfolio not aligning with their KYC information and/or investment policy statement.
- Re-assessment of suitability not performed at the time of a triggering event.
- Insufficient documentation supporting the suitability determination.
- Suitability determination is only conducted at the "household" level.

#### **Disclosure information**



- Insufficient information in the investment management agreement.
- Insufficient and inaccurate information in the offering documents of prospectus-exempt investment funds.
- Inadequate relationship disclosure information:
  - Custodian; limitation on products and services offered; conflicts of interest; dispute resolution services; KYC information; trusted contact person; and temporary holds.
- Updated relationship disclosure information not provided to clients.

#### **Conflicts of interest**



- Addressing material conflicts of interest only with disclosure.
- Inadequate response to material conflicts of interest:
  - Use of client consent as only response.
  - Only performing suitability determination for related party products.
- Failure to identify and address material conflicts of interest (i.e. fee arrangements, referral arrangements, and in-house net asset value calculations).
- Inadequate or no disclosure of material conflicts of interest.
- Inadequate conflicts of interest record keeping.
- Failure to obtain client consent for managed account trades in related securities.

# **Client reporting**



- Inadequate information included in statements.
- Failure to provide report on charges and other compensation and/or investment performance report to clients.
- Household statements provided instead of:
  - a separate statement for each client account;
  - > separate annual reports for each client account (or for each client with written consent).

## Marketing



- Misleading and inadequate marketing materials:
  - Unsubstantiated, unbalanced and/or exaggerated claims.
  - > Performance return data does not disclose the applicable time period.
  - Source of information for third party information is not disclosed.
  - > Activities of institutional investors without adequate disclosures.
- Unregistered individuals or companies holding themselves out as registered.
- Inappropriate use of business or trade names.
- Inappropriate use of corporate officer titles by client-facing registered individuals.

# Policies and procedures



- Inadequate or not in existence in certain areas of the firm's operations.
- Not updated to include client-focused reforms amendments, specifically, KYC, suitability, KYP and conflicts of interest.
- Obtained from a template without tailoring to the firm's operations.

# Referral arrangements



- Inadequate or no referral agreements in place.
- Agreements were not dated or signed by a representative of the firm.

#### Insurance



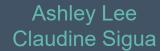
- Inadequate insurance coverage.
- Changes to a registrant's insurance policy not communicated to the ASC.

# Fund and trust accounting



- Failure to provide supporting documentation of the determination of net asset value.
- Inappropriate expenses charged to the fund.
- Inadequate procedures for trust accounts:
  - Interest earned on omnibus trust accounts.
  - Wire fees charged to the fund.
- Inadequate calculations of management fees.

### Contact us



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# Thank you

