

APPENDIX C

PROPOSED AMENDMENTS TO COMPANION POLICY 31-103 CP REGISTRATION REQUIREMENTS, EXEMPTIONS AND ONGOING REGISTRANT OBLIGATIONS

The Canadian Securities Administrators are publishing changes to the Companion Policy for comment. The changes would come into effect on the implementation of the corresponding changes to the Rule.

This Appendix shows the proposed amendments to the Companion Policy against the relevant portions of the consolidation of the Companion Policy published on April 15, 2011.

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14.2 Relationship disclosure information

Content of relationship disclosure information

There is no prescribed form for the relationship disclosure information required under section 14.2. A registered firm may provide this information in a single document or in separate documents, which together give the client the prescribed information.

We expect, as part of the delivery obligation in subsection 14.2(3), that registered individuals spend sufficient time with clients as part of an in-person or telephone meeting to adequately explain the written documents that are delivered under subsection 14.2(2).

~~Disclosure of costs~~Disclosure of charges

The registered firm's compensation and the charges to a client will vary depending on the type of relationship with the client and the nature of the services and investment products offered.

At account opening, registered firms must provide clients with general information on the charges that the clients may incur and compensation the firms may receive as a result of their business relationship. A registered firm is not expected to provide information on all the types of accounts that it offers and the fees related to these accounts if this is not relevant to the client's situation. Charges include any amounts charged in respect of a transaction or the investment account of a client, such as

- Commissions
- sales charges
- service charges
- management fees
- transaction fees
- performance fees
- compensation received from third parties such as trailing commissions

While general information on the charges is appropriate at account opening, a firm must provide more specific information as to the nature and amount of the actual charges when it provides services or advises on a trade.

Under subsection 14.2(2)(g), registered firms must provide clients with a description of the ~~costs~~operating and transaction charges they will pay in making, holding and selling investments. We expect this description to include all ~~costs~~charges a client may pay during the course of holding a particular investment. For example, ~~for if a client will be investing in~~ a mutual fund security, the description should briefly explain each of the following and how they may affect the investment:

- the management expense ratio

- the sales charge options available to the client or deferred sales charge option available to the client and an explanation as to how such charges work. This means registered firms should advise clients that mutual funds sold on a deferred sales charge basis are subject to charges upon redemption that are applied on a declining rate scale over a specified period of years, until such time as the charges decrease to zero
- the any trailing commission
- any short-term trading fees
- any fees related to the client changing or switching investments ("switch or change fees")

Another example relates to the rates charged on foreign exchange transactions which may be less transparent. The registrant's disclosure should specify whether the firm charges the client its cost or whether there is a mark-up component.

Registrants should advise clients whether their managed account is permitted to hold securities that pay third party compensation, and whether the fee paid by the client to the registrant will be affected by this. For example, the management fee paid by a client on the portion of a managed account related to mutual fund holdings may be lower than the overall fee on the rest of the portfolio.

Description of content and frequency of reporting

In order to comply with paragraph 14.2(2)(i), registered firms should describe to clients at account opening the following types of reporting that they will provide and the frequency of such reporting:

- client account statements
- trade confirmations for registered dealers
- annual charge and compensation disclosure
- any switch or change fees performance reporting

KYC information

Paragraph 14.2(2)(i) requires registrants to provide their clients with a copy of their KYC information at the time of account opening. We would expect registered firms to also provide a description to the client of the various terms which make up the KYC information, and describe how this information will be used in assessing the client's financial situation, investment objectives, investment knowledge, risk tolerance and in determining investment suitability. From this initial discussion, clients should better understand what their KYC information is being used for.

Disclosure at the time of a transaction

For non-managed accounts, subsection 14.2(3.1) requires disclosure to a client of charges specific to a transaction prior to the acceptance of a client's order. For the purchase of a mutual fund security on a deferred sales charge basis, we would expect this disclosure to also include that a charge may be triggered upon the redemption of the security, if it is sold within the time period that a deferred sales charge would be applicable. The actual amount of the deferred sales charge, if any, would need to be disclosed once the security is redeemed. This disclosure is not required to be in writing. Specific charges should be reported in writing on the trade confirmation as required in section 14.12.

Switch or change fees

We consider that providing clients with adequate disclosure of the charges at the time of a transaction will also help clients to be aware of the implications of proposed transactions and deter registered firms from transacting for the purpose of generating commissions. For example, changing a client's investment from a fund sold on a deferred sales charge basis when the charge period has lapsed to a similar fund sold on a sales charge basis would result in the client paying commissions that would otherwise have been avoided.

We are also of the view that a registered firm should not switch the client's investment in the same fund from units sold on a deferred sales charge basis when the charge period has lapsed to those sold on a sales charge basis in order to generate a higher amount of trailing commissions with no corresponding financial benefit to the client. These

types of transactions are in our view inconsistent with a registrant's duty to act fairly, honestly and in good faith. Requiring sufficient disclosure of the charges the client may pay and the firm's compensation will provide investors with important information about their investments.

We would also expect all changes or switches to a client's investments to be accurately reported on trade confirmations by reporting each of the purchase and sale transactions making up the change or switch, as required in section 14.12, with a description of the associated charges.

Annual charge and compensation disclosure

Under paragraph 14.2(4.1)(a), registered firms must provide clients on an annual basis with their current account operating charges that are relevant to the type of account(s) held by the client. For example, these may include annual registered plan fees and any other charges associated with maintaining and using a registered account. We do not expect registered firms to provide clients with information on product-related charges since the range of products offered by a registrant may be quite broad and the types of products in a client's account may change over time.

Subsection 14.2(4.1) also requires registered firms to provide clients, on an annual basis, with information on the nature and dollar amount of each type of charge paid by the client during the 12 month period. This would include such charges as commissions, switch or change fees, performance fees and early redemption fees. Registered firms must also disclose the amount of trailing commissions they received related to the client's holdings and provide disclosure on the amount of any other type of compensation received by a third party, including a non-arm's length entity, such as referral fees, success fees on the completion of a transaction or finder's fees.

Registrants must also identify a client's investment fund holdings that may be subject to a deferred sales charge, regardless of whether or not a charge has been incurred.

Permitted clients

Under subsection 14.2(6), registrants do not have to provide relationship disclosure information to permitted clients if:

- the permitted client has waived the requirements in writing, and
- the registrant does not act as an adviser for a managed account of the permitted client

Promoting client participation

Registered firms should help their clients understand the registrant-client relationship. They should encourage clients to actively participate in the relationship and provide them with clear, relevant and timely information and communications.

In particular, registered firms should encourage clients to:

- **Keep the firm up to date.** Clients should provide full and accurate information to the firm and the registered individuals acting for the firm. Clients should promptly inform the firm of any change to information that could reasonably result in a change to the types of investments appropriate for them, such as a change to their income, investment objectives, risk tolerance, time horizon or net worth.
- **Be informed.** Clients should understand the potential risks and returns on investments. They should carefully review sales literature provided by the firm. Where appropriate, clients should consult professionals, such as a lawyer or an accountant, for legal or tax advice.
- **Ask questions.** Clients should ask questions and request information from the firm to resolve questions about their account, transactions or investments, or their relationship with the firm or a registered individual acting for the firm.
- **Stay on top of their investments.** Clients should pay for securities purchases by the settlement date. They should review all account documentation provided by the firm and regularly review portfolio holdings and performance.

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14.12 Content and delivery of trade confirmation

Section 14.12 requires registered dealers to deliver trade confirmations. A dealer may enter into an outsourcing arrangement for the sending of trade confirmations to its clients. Like all outsourcing arrangements, the registrant is ultimately responsible for the function and must supervise the service provider. See Part 11 of this Companion Policy for more guidance on outsourcing.

Trades in fixed income securities

Under paragraph 14.12(1)(b.1), registered dealers must provide the yield of a fixed income security on trade confirmations. For non-callable fixed income securities, the yield to maturity would be appropriate, while for callable securities, the yield to call may be more useful.

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14.14 Account statements

Account statements generally

Section 14.14 requires registered dealers and advisers to deliver statements to clients at least once every three months. There is no prescribed form for these statements but they must contain the information in subsections 14.14(4), (5) and (5.2). The types of transactions that must be disclosed in an account statement include any purchase, sale or transfer of securities, dividend or interest payment received or reinvested, any fee or charge, and any other account activity.

We expect all dealers and advisers to provide client account statements. For example, an exempt market dealer should provide an account statement that contains the information prescribed for all transactions the exempt market dealer has entered into or arranged on a client's behalf.

The requirement to produce and deliver an account statement may be outsourced. Portfolio managers frequently enter into outsourcing arrangements for the production and delivery of account statements. Third-party pricing providers may also be used to value securities for the purpose of account statements. Like all outsourcing arrangements, the registrant is ultimately responsible for the function and must supervise the service provider. See Part 11 of this Companion Policy for more guidance on outsourcing.

Market value of securities

Where possible, market value should be determined by reference to a quoted value on a recognized exchange or marketplace. If market value is not quoted on an exchange (e.g. bonds) market value may be determined by reference to quotes that are available through brokers. We recognize that it is not always possible to obtain a market value by these methods. In such cases, we will accept a valuation policy that is consistently applied and is based on measures considered reasonable in the industry, such as value at cost where there has been no material subsequent event (e.g. a market event or new capital raising by the issuer).

Under subsection 14.14(5.1), where a market value of a security cannot be determined, the registered firm must disclose this in the account statement and exclude the security from the calculation of the total market value in paragraph (e). If the registered firm can subsequently determine a market value for that security, the market value should be included in the account statement, accompanied at that time with adequate notes explaining that a market value is now determinable.

Once a market value is subsequently determinable for a security, registered firms may also need to add that value to the amount reported under paragraph 14.16(1)(a) (net amount invested) . This would be expected if the firm had previously assigned the security a value of zero in the calculation of net amount invested because it could not determine the security's market value, as required by subsection 14.16(5) This would reduce the risk of presenting a misleading improvement in the performance of the account by only adding the value of the security to the other calculations required under section 14.16. If the contributions used to purchase the security were already included in the calculation of net amount invested, the registered firm would not need to adjust that figure.

Original cost of securities in account statements

Subsection 14.14(5.2) requires the account statement to include the original cost of each security position. This is the total amount paid for a security, including any commissions or related fees. Registered firms may choose whether to

disclose original cost on an aggregate basis for each security position or on an average per security basis. Original cost information will allow investors to readily compare the market value of security positions to the original cost on their statement to assess how well an investment is performing.

Where the original cost information is unavailable, registrants may elect to substitute market value information as at a certain point in time as the cost going forward. For example, where the account was transferred in to the registrant firm, the market value assigned to the securities could be that as at the date the account was received in by way of transfer, and this could be used instead of original cost.

For an existing account where security cost records are incomplete or known to be inaccurate, the market value as at the [implementation] date or an earlier date may be used, provided that the date and value selected for the security is applied consistently to all client accounts for which cost information is incomplete or inaccurate. If the market value cannot be reliably measured for a security position, the cost information should be reported as not determinable.

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14.15 Performance reports

A performance report must be provided to clients every 12 months as part of, or together with, the account statement. We expect registered firms will give this information sufficient prominence among their client reporting materials so that a reasonable investor can readily locate it. For example, the prominence of this information may be enhanced by putting this information on the first page of the account statement or a bold cross-reference to the performance reporting on the face of the account statement.

14.16 Content of performance reports

The performance reporting disclosure must include explanatory notes and definitions of key performance terms as outlined in paragraphs 14.16(1)(e) and (h) and included in section 1.1. We would expect these notes to explain the information presented and how an investor can use it to assess the account performance. The use of both text and a table, graph or chart is required. The information in each of the combinations of paragraphs 14.16(1)(a) and (b), (c) and (d), and (f) would be usefully presented together.

The disclosure may also include

- additional definitions of the various performance measures used by the registrant
- additional disclosure that enhances the performance presentation
- a discussion with clients about what the information means to them

Registered firms are encouraged to meet with clients, as part of an in-person or telephone meeting, to adequately explain their performance reporting and how it relates to the client's objectives and risk tolerance.

Appendix D of this Companion Policy includes a sample Account Performance Report which registered firms are encouraged to use as guidance. This includes the information required to be reported in paragraphs 14.16(1)(a) to (h), as well as sample explanatory notes.

Net amount invested

As part of paragraph 14.16(1)(a), registered firms must disclose the net amount invested in the client's account. This is the sum of all contributions and transfers in of cash or securities less all withdrawals and transfers out of cash or securities. The definition of net amount invested should accompany the information required to be presented under section 14.16.

The net amount invested should be presented from the time of account opening. If this information is not historically available, registered firms may present the market value of all securities and cash in the account as of [the implementation date] as a substitute and disclose this basis of presentation to clients. In these cases and for purposes of calculating the change in value of the account since inception required in subsection (d), an opening market value at the implementation date and the net amount invested since the implementation date will be used instead of the net amount invested.

Subsection 14.16(5) requires a registered firm that cannot determine the market value for a security position to assign the security a value of zero for the purposes of calculating net amount invested. As described in section 14.14 of this Companion Policy, if a registered firm is subsequently able to value that security it may need to adjust the calculation of net amount invested to avoid presenting a misleading improvement in the performance of the account.

The net amount invested as described above should be compared to the market value of the account as at the end of the 12 month period for which the performance reporting is provided in order to provide clients, in dollar terms, with the performance and the worth of their account.

Change in value

Registered firms are also required to disclose the change in the value of a client's account since inception and for the 12 month period under paragraphs 14.16(1)(c) and (d). The change in the value of the account since inception is the difference between the ending market value of the account and the net amount invested since inception. The change in the value of the account for the 12 month period is the difference between the ending market value of the account and the opening market value and net amount invested during the period.

Generally, the change in value is a reflection of the market performance of the account and includes components such as reinvested income (dividends, interest) and distributions, cash distributions, unrealized capital gains or losses in the account and the effect of account and transaction charges if these are deducted directly from the account. Rather than show the change in value as a single amount, registered firms may opt to break this out into its components to provide more detail to clients.

Percentage return calculation methods

Paragraph 14.16(1)(f) permits the use of either a time weighted or dollar weighted performance calculation method for percentage returns. Different techniques within each method such as the Dietz and modified Dietz methods are permitted. The method and technique used should be those that best reflect how a client's investments have performed and should be used consistently by the registered firm for comparability from one reporting period to the next. If the performance calculation method is changed, the client should be informed of the change and the reason for the change, as well as the difference in the performance return as a result of adopting the new method.

Benchmark information reporting

The use of benchmarks for account performance is not prescribed. However, when the use of benchmarks has been agreed to between the registered firm and the client, this agreement must be documented and form part of the client's agreement with the registered firm as required under section 14.17. Further, we expect dealers and advisers in these instances to provide their clients with a meaningful and relevant benchmark against which the performance of the client's account can be compared.

If registered firms present benchmark information, they should ensure that the benchmark information presented is not misleading. We expect registrants to use benchmarks that are

- discussed with clients to ensure they reflect the diversity of the client's portfolio and meet their information needs
- based on widely recognized and available indices that are credible and not manufactured by the registrant or any of its affiliates using proprietary data
- broad-based securities market indices which can be linked to the major asset classes into which the client's portfolio is divided. The determination of a major asset class should be based on the firm's own policies and procedures and the client's portfolio composition. An asset class for benchmarking purposes may be based on the type of security and geographical region. We do not expect an asset class to be determined by industry sector

Examples of acceptable benchmarks would include, but are not limited to, the S&P/TSX Composite index for Canadian equities, the S&P 500 index for U.S. equities, and the MSCI EAFE index as a measure of the equity market outside of North America.

- presented for the same reporting periods as the client's annualized compound percentage returns
- clearly named

- applied consistently from one reporting period to the next for comparability reasons, unless there has been a change to the pre-determined asset classes. In this case, the change in the benchmark(s) presented should be discussed with the client and included in the explanatory notes, along with the reasons for the change

Registered firms may add additional commentary or explanatory notes to the benchmark presentation. The explanatory notes may reinforce the relevance of the benchmarks presented and can include all facts that could alter materially the conclusions drawn by the comparison. For example, the notes could include a discussion of the differences between the benchmark presented and the investment strategy of the client to make the comparison fair and not misleading.

A discussion of the impact of account fees would also be helpful to clients since benchmarks do not factor in investment costs. Also, this could include differences between the calculation methodology used for the client's returns and those used for calculating the benchmarks and the implication of the use of different methods.

Performance reporting periods

Subsection 14.16(3) outlines the minimum reporting periods of 1, 3, 5 and 10 years and the period since the inception of the account. Registered firms may opt to provide more frequent performance reporting. However performance returns for periods of less than one year should not be misleading and therefore, must not be presented on an annualized basis as outlined in subsection 14.16(4).

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