Policy Statement to Regulation 23-102 respecting Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)

PART 1 – INTRODUCTION

1.1 Introduction – The purpose of this Policy Statement is to provide guidance regarding the various requirements of Regulation 23-102 respecting Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements) (the "Regulation"), including:

(a) a discussion of the general regulatory purposes for the Regulation;

(b) the interpretation of various terms and provisions in the Regulation; and

(c) guidance on compliance with the Regulation.

1.2 General – Registered dealers and advisers have a fundamental obligation to act fairly, honestly, and in good faith with their clients. In addition, securities legislation in some jurisdictions requires managers of mutual funds to also exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances. The Regulation is intended to provide more specific parameters for the use of client brokerage commissions. This Policy Statement provides guidance on the characteristics of the goods and services that may be paid for with brokerage commissions, and provides some examples of certain types of permitted and non-permitted goods and services. The Regulation also sets out disclosure requirements for advisers.

PART 2 – APPLICATION OF THE REGULATION

2.1 Application – In addition to registered dealers, the Regulation applies to advisers. The reference to "advisers" includes registered advisers and registered dealers that carry out advisory functions but are exempt from registration as advisers. The Regulation governs all trading of securities where payment is made with brokerage commissions, as set out in Section 2.1. The reference to "brokerage commissions" includes any commission or similar transaction-based fee. The Regulation would therefore apply to trades executed by the dealer on both a principal or agency basis, so long as brokerage commissions are charged. This may include transactions done on a net basis, if a fee can be separately broken out.

PART 3 – ORDER EXECUTION SERVICES AND RESEARCH

3.1 Definitions of Order Execution Services and Research – (1) Section 1.1 of the Regulation includes the definitions of order execution services and research and provides the broad characteristics of both.

(2) The definitions do not specify what form (e.g., electronic or paper) the order execution services or research should take, as it is the substance that is relevant in assessing whether the definitions are met.

(3) An adviser's responsibilities include determining whether any particular good or service, or portion thereof, may be paid for with brokerage commissions. In making this determination, the adviser is required under Part 3 of the Regulation to ensure both that the good or service meets the definition of order execution services or research and that it benefits the adviser's client(s).

3.2 Order Execution – (1) Section 1.1 of the Regulation defines order execution services as including order execution, as well as other goods and services directly related to order execution. For the purposes of the Regulation, the term "order execution", as opposed to "order execution services", means the entry, handling or facilitation of an order by a dealer, but not other tools that are provided to aid in the execution of trades.

(2) To be considered directly related to order execution, goods and services should generally be integral to the arranging and conclusion of the securities transactions that generated the commissions. A temporal limitation should be applied to ensure that only goods and services received by an adviser that are directly related to the execution process are considered order execution services. As a result, goods and services provided between the point at which an adviser makes an investment or trading decision and the point at which the resulting securities transaction is concluded would generally be considered order execution services. The conclusion of the resulting securities transaction occurs at the point that settlement is clearly and irrevocably completed.

(3) For example, order execution services may include trading advice, such as advice from a dealer as to how to trade an order (to the extent it relates to the execution of a specific order and is provided after the point at which the investment or trading decision is made by the adviser), custody, clearing and settlement services that are directly related to an executed order that generated commissions, algorithmic trading software and raw market data, to the extent they assist in the execution of orders.

3.3 Research – (1) The Regulation defines research as advice, analyses or reports regarding various subject matter relating to investments or trading. In Part 3 of the Regulation, there are also requirements relating to the adviser's responsibility to ensure the research adds value to investment or trading decisions. In order to add value to an investment or trading decision, research should include the expression of reasoning or knowledge and contain original thought. Information or conclusions that are commonly known or self-evident would not qualify. Permitted research may be based on both new and existing facts but should be capable of providing new insights, and not be merely a restatement or repackaging of previously stated information or conclusions. Similarly, research should involve the analysis or manipulation of information or data in arriving at meaningful conclusions. Information or data that has not been analyzed or manipulated does not reflect original thought or the expression of reasoning or knowledge. Additionally, a general characteristic of research is that, in order to link it to order execution, it should be provided before an adviser makes an investment or trading decision.

(2) For example, traditional research reports and advice as to the value of securities and the advisability of effecting transactions in securities would generally be considered research. Other examples include quantitative analytical software, market data that has been analyzed or manipulated to arrive at meaningful conclusions, and post-trade analytics from prior transactions (to the extent they help determine a subsequent investment or trading decision).

3.4 Mixed-Use Items – (1) Mixed-use items are those goods and services that contain some elements that may meet the definitions of order execution services or research, and other elements that either do not meet the definitions or that would not meet the requirements of Part 3 of the Regulation. Where mixed-use items are received by an adviser, the adviser should make a reasonable allocation of the brokerage commissions paid according to the use of the goods and services. For example, a portion of the cost of post-trade analytics might be considered to be research, but advisers should use their own funds to pay for the portion that would not be considered research (for example, the portion used for compliance or internal performance monitoring).

(2) Advisers are expected to keep adequate books and records concerning the allocations made to ensure that brokerage commissions paid by clients are not used to pay for the components of mixed-use items that did not directly benefit the clients.

3.5 Non-Permitted Goods and Services – (1) Certain goods and services are not permitted as order execution services or research under the Regulation because they are not sufficiently linked to the securities transactions that generated the commissions in order to qualify. Goods and services that relate to the operation of an adviser's business rather than to the provision of services to its clients would not meet the requirements of Part 3 of the Regulation. For example, office furniture and equipment (including computer hardware), trading surveillance or compliance systems, portfolio valuation and performance

measurement services, computer software that assists with administrative functions, legal and accounting services, memberships, mass-marketed or publicly-available information or publications, seminars, marketing services, and services provided by the adviser's personnel (e.g. payment of salaries, including those of research staff) would not be allowed.

PART 4 – OBLIGATIONS OF ADVISERS AND REGISTERED DEALERS

4.1 Obligations of Advisers – (1) Subsection 3.1(1) of the Regulation restricts an adviser from entering into any arrangements to use any portion of brokerage commissions for purposes other than as payment for order execution services or research, as defined in the Regulation. Arrangements consist of both formal and informal arrangements, including those informal arrangements for the receipt of such goods and services from a dealer offering proprietary, bundled services.

(2) Subsection 3.1(2) of the Regulation requires an adviser that uses brokerage commissions as payment for order execution services or research to ensure that certain criteria are met. The criteria include that the order execution services or research acquired are for the benefit of the adviser's client(s). The adviser should have adequate policies and procedures in place to allocate, on a fair and reasonable basis, the goods and services received to its client(s) whose brokerage commissions were used as payment for those goods and services.

4.2 Obligations of Registered Dealers – Section 3.2 of the Regulation does not restrict a registered dealer from forwarding to a third party, on the instructions of an adviser, any portion of the commissions it has charged on brokerage transactions to pay for order execution services or research provided to the adviser by that third party.

PART 5 – DISCLOSURE OBLIGATIONS

5.1 Timing of Disclosure – (1) Part 4 of the Regulation requires an adviser to make certain initial and periodic disclosure to its clients. Initial disclosure should be made before an adviser starts conducting business with each of its clients and then periodic disclosure should be made at least annually. The period of time chosen for the periodic disclosure should be consistent from period to period.

(2) For existing accounts, an adviser should make the initial disclosure by the earlier of six months from the date the Regulation takes effect and the date the adviser makes its first periodic disclosure. If the date of the initial disclosure for existing accounts precedes that of the first periodic disclosure, the adviser may choose to make only the disclosure required by subsection 4.1(1)(a) of the Regulation for this purpose.

5.2 Adequate Disclosure – (1) For the purposes of subsection 4.1(a) of the Regulation, disclosure of the arrangements relating to the use of brokerage commissions should include whether the adviser has entered into any such arrangements, and whether those arrangements involve goods and services provided directly or by a third party. Disclosure of the types of goods and services provided by each of the dealers and third parties named should be sufficient to provide adequate description of the goods and services received (e.g., algorithmic trading software, research reports, trading advice, etc.).

(2) For the purposes of subsection 4.1(b) of the Regulation, the brokerage commissions paid by the adviser during the period reported upon should be disclosed for each security class for which such commissions were paid, for example for equity securities, options, etc. The amount is to be disclosed both on an aggregate basis for all accounts or portfolios, and then separately for each of the accounts or portfolios managed by the adviser on behalf of the client to whom the disclosure is made.

(3) Subsection 4.1(c) of the Regulation requires disclosure of the percentages of the brokerage commissions charged, on both an aggregate and account-by-account (or portfolio-by-portfolio) basis, for trades that fall within certain categories. The purpose of this disclosure is to provide clients with clearer information about the use of the brokerage

commissions spent on their behalf, and to provide more transparency about advisers' execution and allocation practices. The categories are as follows:

(a) "order execution only" trades, which, for the purposes of the Regulation, refers to the entry, handling or facilitation of an order by a dealer, which may range from "direct market access" trades to trades where the dealer is more actively involved, for example by providing capital, working the order, etc.;

(b) trades where order execution is bundled with other proprietary services by the dealer(s), such as advice as to trading strategy, research, access to issuer management, etc.;

(c) trades where a portion of the commission is set aside for payment to third parties for goods and services such as independent research, analytical software, etc, divided into three further sub-categories: the fraction allocated to third party research, to other third-party services and that retained by the dealers.

(4) For the purposes of subsection 4.1(d) of the Regulation, the weighted average brokerage commission per unit of security is the total amount of brokerage commissions paid divided by the total number of units of securities in the trades that generated those brokerage commissions. The calculations should be done separately for each of the percentages and fractions disclosed in subsections 4.1(c)(i) through (iii) of the Regulation. (5) In order for the initial disclosure required under section 4.1 of the Regulation to be considered adequate, the adviser should provide the client with the most recent periodic disclosure, in relation to that section, that had been provided to the adviser's existing clients. The initial disclosure would not include any of the client-specific disclosure required under subsections 4.1(b) through (d) of the Regulation but should include the related aggregated brokerage commission disclosure.

(6) Subsection 4.1(2) of the Regulation requires an adviser to maintain certain details of the goods and services received for which payment was made with brokerage commissions, and to make this information available to its clients, upon request. In order to be able to meet this requirement, the adviser should maintain the information in such a manner as to facilitate requests for details covering any specified period of time. The adviser should maintain these details relating to the most recent five years.

(7) An adviser should disclose any additional information it believes would be helpful to its clients.

5.3 Form of Disclosure – Part 4 of the Regulation does not specify the form of disclosure. The form of disclosure may be determined by the adviser based on the needs of its clients, but the disclosure should be provided in conjunction with other initial and periodic disclosure relating to the management and performance of the account, portfolio, etc. For managed accounts and portfolios, the initial disclosure could be included as a supplement to the management agreement or account opening form, and the periodic disclosure could be provided as a supplement to a statement of portfolio.