POLICY STATEMENT TO *REGULATION 23-102 RESPECTING USE OF CLIENT BROKERAGE COMMISSIONS AS PAYMENT FOR ORDER EXECUTION SERVICES OR RESEARCH SERVICES*

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 Services* (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 where "client brokerage commissions" are defined as those brokerage commissions that are ultimately paid for out of, or charged to, the client accounts or investment funds managed by advisers. The Regulation also sets out disclosure requirements for advisers. This Policy Statement provides guidance on (a) the characteristics of the goods and services that may be paid for with client brokerage commissions, including some examples of permitted and non-permitted goods and services; (b) the obligations of advisers and registered dealers; and (c) the disclosure obligations.

PART 2 APPLICATION OF THE REGULATION

2.1. Application

(1) The Regulation applies to advisers and registered dealers. 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 certain trades in securities where payment is made with client brokerage commissions, as set out in section 2.1 of the Regulation. The reference to "client brokerage commissions" includes any commission or similar transaction-based fee charged for a trade where the amount paid for the security is clearly separate and identifiable (e.g., the security is exchange-traded, or there is some other independent pricing mechanism that enables the adviser to accurately and objectively determine the amount of commissions or fees charged).

(2) The limitation of the Regulation to trades for which a brokerage commission is charged is based on the practical difficulties in applying these requirements to transactions such as principal transactions where a mark-up is charged. Advisers that obtain goods and services other than order execution in conjunction with such transactions will remain subject to their general fiduciary obligations to deal fairly, honestly and in good faith with clients, but will not be able to rely on the Regulation to demonstrate compliance with those obligations.

PART 3 ORDER EXECUTION SERVICES AND RESEARCH SERVICES

3.1. Definitions of Order Execution Services and Research Services

(1) Section 1.1 of the Regulation includes the definitions of order execution services and research services and provides the broad characteristics of both.

(2) The definitions do not specify what form (e.g., electronic or paper) the services 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 client 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 services and that it benefits its client(s).

3.2. Order Execution Services

(1) Section 1.1 of the Regulation defines "order execution services" as including the actual execution of the order itself, 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 whether by a dealer or by an adviser through direct market access, but not other goods or services 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 transactions that generated the commissions. A temporal standard should be applied to ensure that only goods and services used by an adviser that are directly related to the execution process are considered order execution services. As a result, we generally consider that goods and services directly related to the execution process would be provided or used between the point at which an adviser makes an investment decision (i.e., the decision to buy or sell a security) and the point at which the resulting securities transaction is concluded. 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, when or where 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 decision is made by the adviser), order management systems (to the extent they help arrange or effect a securities transaction), algorithmic trading software and market data (to the extent they assist in the execution of orders), post-trade analytics from prior transactions (to the extent they are used to aid in a subsequent decision of how, when or where to place an order), and custody, clearing and settlement services that are directly related to an executed order that generated commissions.

3.3. Research Services

(1) The Regulation defines research services as advice, analyses or reports regarding various subject matter relating to investments, as well as databases and software that support these services. In order to be eligible, research services generally should reflect the expression of reasoning or knowledge and be related to the subject matter referred to in the definition (i.e., securities, portfolio strategy, etc.). We would also consider databases and software that are used by advisers in support of or as an alternative to the provision by dealers of advice, analyses and reports to be research services to the extent they relate to the subject matter referred to in the definition. Additionally, a general characteristic of research services is that, in order to link these to order execution, they should be provided or used before an adviser makes an investment decision.

(2) For example, traditional research reports, publications marketed to a narrow audience and directed to readers with specialized interests, and seminars and conferences (i.e., fees, and not incidental expenses such as travel, accommodations and entertainment costs) would generally be considered research services. Databases and software that could be eligible as research services could include quantitative analytical software, market data from feeds or databases that has been or will be analyzed or manipulated to arrive at meaningful conclusions, and possibly order management systems (to the extent they provide research or assist with the research process).

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 services, 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 obtained by an adviser with client brokerage commissions, the adviser should make a reasonable allocation of those commissions paid according to the use of the goods and services. For example, advisers might use client brokerage commissions to pay for the portion of order management systems used in the order execution process, but should use their own funds to pay for any portion of the systems used for compliance, accounting or recordkeeping purposes.

(2) For purposes of making a reasonable allocation, an adviser should make a good faith estimate supported by a fact-based analysis of how the good or service is used, which may include inferring relative costs from relative benefits. Factors to consider might include the relative utility derived from, or the time the good or service is used for, eligible and ineligible uses.

(3) Advisers are expected to keep adequate books and records concerning the allocations made.

3.5. Non-Permitted Goods and Services

We consider certain goods and services to be clearly outside the scope of the permitted goods and services under the Regulation because they are not sufficiently linked to the securities transactions that generated the commissions. 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. Examples of these include 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 relating to the management of an adviser's own business or operations, memberships, marketing services, and services provided by the adviser's personnel (e.g. payment of salaries, including those of research staff).

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 client brokerage commissions for purposes other than as payment for order execution services or research services, 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 client brokerage commissions to pay for order execution services or research services to ensure that certain criteria are met. The criteria include that the order execution services or research services acquired are for the benefit of the adviser's client(s). In order to benefit a client, the goods

and services should be used in a manner that provides appropriate assistance to the adviser in making investment decisions, or in effecting securities transactions. A good or service that meets the definition of order execution services or research services, but is not used to assist the adviser with investment decisions, or with effecting securities transactions, should not be paid for with client brokerage commissions. The adviser should be able to demonstrate how the goods and services paid for with client brokerage commissions are used to provide appropriate assistance.

(3) A specific order execution service or research service may benefit more than one client, and may not always directly benefit each particular client whose brokerage commissions were used as payment for the particular service. However, the adviser should have adequate policies and procedures in place to ensure that all clients whose brokerage commissions were used as payment for these goods and services, have received fair and reasonable benefit from such usage.

(4) Paragraph 3.1(2)(b) of the Regulation requires the adviser to ensure that a good faith determination has been made that the amount of client brokerage commissions paid for order execution services or research services is reasonable in relation to the value of the services received. This determination can be made either with respect to a particular transaction or the adviser's overall responsibilities for client accounts. The relevant measure for any such determination is the reasonableness of the amount of client brokerage commissions paid in relation to the order execution services and research services received and used by the adviser. An adviser that, by virtue of paying client brokerage commissions, is provided with access to goods and services, or receives goods or services on an unsolicited basis and does not use such items, will not be considered to be in violation of this obligation if it does not include these in its assessment of value received in relation to commissions paid. However, to the extent that an adviser makes use of any such goods or services, or considers the availability of such goods or services a factor when selecting dealers, the adviser should include these in its assessment of value received for commissions paid. An example of a situation where value received might not be reasonable in relation to value paid is where an adviser has accepted a full-service commission rate without negotiating for an execution-only rate, if the adviser intended only to rely on the dealer for order execution.

4.2. Obligations of Registered Dealers

Section 3.2 of the Regulation clarifies that a registered dealer may only charge and accept brokerage commissions for order execution services and research services. Further, the dealer may forward to a third party, on the instructions of an adviser, any portion of those commissions to pay for order execution services or research services provided to the adviser by that third party.

PART 5 DISCLOSURE OBLIGATIONS

5.1. Disclosure Recipient

Part 4 of the Regulation requires an adviser that has used client brokerage commissions, or any portion thereof, as payment for goods and services other than order execution, to make certain disclosures to its clients. The recipient of the disclosure should typically be the party with whom the contractual arrangement to provide advisory services exists. For example, for an adviser to an investment fund, the client would typically be considered the fund, unless the adviser is also the trustee and/or the manager of the fund, or is an affiliate of the trustee and/or manager of the fund, in which case the adviser should consider whether its relationship with the fund presents a conflict of interest matter under *Regulation 81-107 respecting Independent Review Committee for Investment Funds* that requires review by the Independent Review Committee established in accordance with that Regulation, and whether it would be more appropriate for the disclosure to be made instead to the Independent Review Committee.

5.2. 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 clients at the effective date of the Regulation, the adviser should make initial disclosure within six months of the effective date of the Regulation. If the adviser provides the first periodic disclosure to those clients within that six-month period, then separate initial disclosure would not be necessary. Otherwise, the initial disclosure to be made to those clients need only include the disclosure required by paragraphs 4.1(a) through (e) of the Regulation.

5.3. Adequate Disclosure

(1) For the purposes of the disclosure made under section 4.1 of the Regulation, the requirement on the adviser to provide disclosure regarding the use of its client brokerage commissions would include the use of those commissions by its sub-advisers.

(2) For the purposes of paragraph 4.1(b) of the Regulation, disclosure of the nature of arrangements relating to the use of client brokerage commissions should include whether the adviser or its sub-adviser(s) have entered into any such arrangements, whether those arrangements involve goods and services provided directly by a dealer or by a third party, and a description of the general mechanics of how client brokerage commissions are charged and used to pay for order execution services and research services under these arrangements.

(3) For the purposes of paragraph 4.1(c) of the Regulation, disclosure of the types of goods and services should be sufficient to provide adequate description of the goods and services received (e.g., algorithmic trading software, research reports, trading advice, etc.). Associating the types of goods and services received to each dealer or third party that provided that good or service is not necessary, except in the case of goods and services provided by affiliated entities. Affiliated entities and the types of goods and services each such entity provided should be separately identified. The disclosure made under paragraph 4.1(c) of the Regulation could be made at the firm-wide level, or at the level that corresponds to the level of aggregation or disaggregation of the client brokerage commissions disclosed under paragraph 4.1(g) of the Regulation, depending on the reliability of the information at a level other than firm-wide.

(4) For the purposes of paragraph 4.1(g) of the Regulation, when making disclosure of the aggregated client brokerage commissions paid by the adviser during the period reported upon, consideration should be given to the appropriate level of aggregation or disaggregation of the commission information needed to provide the client with sufficient information regarding the use of client brokerage commissions. For example, advisers that offer only private managed accounts might aggregate at the firm-wide level. Advisers that advise on behalf of multiple types of accounts (e.g. mutual funds, sub-advised accounts, and private managed accounts) might provide disclosure that aggregates for each account type. More granular disaggregation can be provided if the adviser believes it is appropriate; for example, for disclosure to a mutual fund it might be appropriate to disaggregate to the level of the particular mutual fund, rather than across all mutual funds. Advisers that have disaggregated their disclosure should also include firm-wide disclosure.

(5) Other than as indicated in subsection 5.2(2) of this Policy Statement, 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 to meet paragraphs 4.1(a) through (e), and (g) of the Regulation.

(6) An adviser should disclose any additional information it believes would be helpful to its clients. For example, the adviser may determine that a break-out of the amounts disclosed under paragraph 4.1(g) of the Regulation into the components representing research services and other goods or services directly related to order execution provides useful information to its clients. Or, it may choose to include more granular disclosure that is required in another jurisdiction.

5.4. 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.