Canadian Securities Administrators    Autorités canadiennes en valeurs mobilières

# Notice

## Regulation to amend *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*

## Amendments to *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*

## (Cost Disclosure, Performance Reporting and Client Statements)

**March 28, 2013**

**Introduction**

The Canadian Securities Administrators (the CSA or we) are implementing amendments to *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Regulation 31-103) as well as *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the Policy Statement) (collectively, the Amendments). We refer to Regulation 31-103 and the Policy Statement as the "Regulation".

The Amendments are relevant to all categories of registered dealer and registered adviser, with some application to investment fund managers.

The Amendments have been or are expected to be adopted by each member of the CSA. We expect the requirements for members of the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) (together referred to as the self-regulatory organizations or SROs) to be materially harmonized.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Subject to obtaining all necessary approvals, the Amendments will come into force on **July 15, 2013**.

The text of the Amendments to Regulation 31-103 and of the Policy Statement is published with this Notice. The Amendments are available on websites of CSA jurisdictions, including the following:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.gov.ns.ca/nssc

www.nbsc-cvmnb.ca
www.osc.gov.on.ca
www.sfsc.gov.sk.ca

A black-lined extract of the Regulation 31-103, incorporating the Amendments, is available on some CSA websites.

**Substance and Purpose**

The substance and purpose of the Amendments is to ensure that clients of all registrants receive clear and complete disclosure of all charges and registrant compensation associated with the investment products and services they receive, and meaningful reporting on how their investments perform.

**Background**

The CSA have been developing requirements in a number of areas related to a client's relationship with a registrant. This initiative is referred to as the Client Relationship Model (CRM) Project. The first phase of the CRM Project included relationship disclosure information delivered to clients at account opening and comprehensive conflicts of interest requirements, and was incorporated into the Regulation when it came into force on September 28, 2009. These Amendments, proposals for which had been published for initial comment on June 22, 2011 (the 2011 Proposal) and for second comment on June 14, 2012 (the 2012 Proposal), represent the second phase of the CRM Project and introduce performance reporting requirements and enhance existing cost disclosure requirements in the Regulation 31-103, as well as introduce some new client statement requirements.

**Summary of Written Comments Received by the CSA on the 2012 Proposal**

During the second comment period, we received submissions from 65 commenters. We have considered the comments received and thank all of the commenters for their input. A summary of the comments we received on the 2012 Proposal together with our response and a list of the commenters is contained in Annex B to this Notice.

Copies of the comment letters are posted on the following websites:

www.lautorite.qc.ca
www.osc.gov.on.ca

**Summary of Changes to the Regulation**

After considering the comments, we have made some changes to certain of the proposed amendments which were in the 2012 Proposal. As these changes are not material, we are not republishing the Amendments for a further comment period. A description of the key changes we made to the Regulation and the 2012 Proposal is contained in Annex A of this Notice.

### Transition

We are providing for a phased implementation of the Amendments over three years after they come into force. A summary of the transition periods is included in Annex A.

### Local Matters

Certain jurisdictions are publishing other information required by local securities legislation in an Annex of this Notice.

### Questions

Please refer your questions to any of the following:

Christopher Jepson
Senior Legal Counsel
Compliance and Registrant Regulation
Ontario Securities Commission
416-593-2379
cjepson@osc.gov.on.ca

Brian W. Murphy
Deputy Director, Capital Markets
Nova Scotia Securities Commission
902-424-4592
murphybw@gov.ns.ca

Gérard Chagnon
Analyste expert en réglementation
Direction des pratiques de distribution et des OAR
Autorité des marchés financiers
418-525-0337, ext 4815 and
1-877-525-0337 (Toll-free)
gerard.chagnon@lautorite.qc.ca

Ella-Jane Loomis
Legal Counsel
New Brunswick Securities Commission
506-658-3060
ella-jane.loomis@nbsc-cvmnb.ca

Kate Lioubar
Senior Legal Counsel
Capital Markets Regulation
British Columbia Securities Commission
604-899-6628 and
1-800-373-6393
klioubar@bcsc.bc.ca

Katharine Tummon
Director
Office of the Superintendent
of Securities, P.E.I.
902-368-4542
kptummon@gov.pe.ca

Navdeep Gill
Manager, Registration
Alberta Securities Commission
403-355-9043
navdeep.gill@asc.ca

Craig Whalen
Manager of Licensing, Registration and Compliance
Office of the Superintendent of Securities
Government of Newfoundland and Labrador
709-729-5661
cwhalen@gov.nl.ca

Dean Murrison
Director, Securities Division
Financial and Consumer Affairs Authority of Saskatchewan
306-787-5842
dean.murrison@gov.sk.ca

Chris Besko
Deputy Director, Legal Counsel
The Manitoba Securities Commission
204-945-2561 and 1-800-655-5244
(Toll Free (Manitoba only))
chris.besko@gov.mb.ca

Carla Buchanan
Compliance Auditor
The Manitoba Securities Commission
204-945-2561 and 1-800-655-5244
(Toll Free (Manitoba only))
carla.buchanan@gov.mb.ca

Louis Arki
Director, Legal Registries
Department of Justice, Government of Nunavut
867-975-6587
larki@gov.nu.ca

Rhonda Horte
Deputy Superintendent
Office of the Yukon Superintendent of Securities
867-667-5466
rhonda.horte@gov.yk.ca

**ANNEX A**

**Summary of Changes to the Regulation**

This Annex describes the key changes we made to the Regulation and the 2012 Proposal.

This Annex contains the following sections:

1. Definitions
2. Investment fund managers
3. Relationship disclosure information
4. Pre-trade disclosure of charges
5. Determining market value
6. Trade confirmation – disclosure for debt security transactions
7. Account statements, additional statements and security holder statements
8. Report on charges and other compensation
9. Investment performance report
10. Scholarship plan dealers
11. Transition
12. Sample reports

In this Annex, we reference the sections and paragraphs of Regulation 31-103 except where otherwise indicated. Some sections and paragraphs have been re-numbered from the 2012 Proposal.

## 1. DEFINITIONS

We have added definitions under section 1.1 for the following terms: book cost, operating charge, original cost, total percentage return, trailing commission and transaction charge.

## 2. INVESTMENT FUND MANAGERS

We have added a requirement under subsection 14.1.1 for investment fund managers to provide dealers and advisers with information concerning deferred sales charges and any other charges deducted from the net asset value of securities, and trailing commissions to dealers and advisers in order that they may comply with paragraphs 14.12(1)(c) and 14.17(1)(h). We have provided a transition period of three years for this requirement and for the corresponding requirements for dealers and advisers. We expect investment fund managers and dealers and advisers who distribute their funds to work together to ensure that clients will be provided with the required information in trade confirmations as of July 15, 2016, and in reports on charges and other compensation for periods from that date forward.

## 3. RELATIONSHIP DISCLOSURE INFORMATION

In section 14.2, we replaced the term "costs" with "charges" to avoid confusing the charges associated with the operation of an account or executing transactions with the actual purchase cost of a security. We also clarified the expectations for relationship disclosure information that is required to be provided under this section, and added new provisions summarized below.

### Benchmarks

Paragraph 14.2(2)(m) requires firms to provide each client with a general explanation of benchmarks and whether the firm offers any options for benchmark reporting to clients.

Guidance on the use of benchmarks that are meaningful and not misleading has been added to the Policy Statement. We have removed the discussion that was in the 2012 Proposal encouraging firms to include an historical five-year GIC rate in performance reports as an easily understood benchmark because this may not be the most relevant comparison reflective of the composition of a client's portfolio.

### Responsibility for dealer directed by a registered adviser

Subsections 14.2(7) and 14.2(8) provide that only limited relationship disclosure information must be delivered by a dealer where the dealer purchases or sells securities only as directed by a registered adviser acting for the client.

### New or increased operating charge

Subsection 14.2(5.1) requires firms to provide their clients with 60 days written notice of any new or increased operating charge. This is consistent with SRO requirements.

## 4. PRE-TRADE DISCLOSURE OF CHARGES

In section 14.2.1, we added a requirement for registered firms to provide specific disclosure of the charges a client with a non-managed account would have to pay when purchasing or selling a security prior to the registrant accepting the client's order. This section does not apply to a registered firm in respect of a permitted client that is not an individual, nor does it apply to a dealer in respect of a client for whom the dealer purchases or sells securities only as directed by a registered adviser acting for the client.

**Switch or change transactions**

We have added a discussion on switch or change transactions in the Policy Statement. We have revised the Policy Statement discussion that was in the 2012 Proposal to remove the examples that were previously given as we have concluded that there is no standard approach to switch or change transactions and the examples may be confusing.

## 5. DETERMINING MARKET VALUE

We have added section 14.11.1 which sets out a methodology for registrants to use to determine the market value of securities for the purpose of reporting to clients.

Paragraph 14.11.1(1)(a) requires the market value of a security that is issued by an investment fund not listed on an exchange to be determined by reference to the net asset value provided by the investment fund manager of the fund on the relevant date. For other securities, a hierarchy of valuation methods that depend on the availability of relevant information is prescribed under paragraph 14.11.1(1)(b).

Subsection 14.11.1(3) provides that where the registered firm reasonably believes that it cannot determine the market value for a security, the firm must report that no market value can be determined and the security must not be included in the calculation of the total market value of cash and securities in the client's account or in calculations for the investment performance report.

## 6. TRADE CONFIRMATION – DISCLOSURE FOR DEBT SECURITY TRANSACTIONS

We have amended section 14.12 to require registrants to report compensation from debt securities transactions. Registrants may either disclose: (a) the total dollar amount of compensation (which may consist of any mark-up or mark-down, commission or other service charge), or (b) the total dollar amount of any commission paid to the firm and, if the registrant applied a mark-up or mark-down or any service charge other than a commission, provide a prescribed general notification. This is a change from the 2012 Proposal where we had proposed to require registrants to report the total dollar amount of compensation paid to dealing representatives and include a general notification about possible dealer firm compensation.

## 7. ACCOUNT STATEMENTS, ADDITIONAL STATEMENTS AND SECURITY HOLDER STATEMENTS

**Account statements**

Under section 14.14, registered dealers and advisers continue to be required to deliver an account statement, comprised of two sections:

- under subsection 14.14(4), the dealer or adviser is required to report specified information about all transactions carried out during the reporting period

- under subsection 14.14(5), the dealer or adviser is required to report specified information which, from July 15, 2015, will relate only to securities that are held by the registered firm

We have amended subsection 14.14(3) with respect to advisers to clarify that they must deliver statements to clients at least once every 3 months. We have also clarified that an adviser must deliver statements on a monthly basis if requested to do so by a client.

We have amended subsection 14.14(4) to carve out transfers from the requirements to provide the price per security and the total value of the transaction. We acknowledge that there is an acceptable established practice where some firms do not report a price or total value for transferred securities in the transaction section of an account statement.

**Additional statements**

We have added under new section 14.14.1, a requirement effective July 15, 2015 for registered dealers and advisers to deliver to clients a statement that provides information generally corresponding to that required under subsection 14.14(5) in respect of securities held by a party other than the dealer or adviser if:

- the dealer or adviser has trading authority over the security or the account of the client in which the security is held or was transacted

- the dealer or adviser receives continuing payments related to the client's ownership of the security from the issuer of the security, the investment fund manager of the issuer or any other party

- the security is issued by a scholarship plan, a mutual fund or an investment fund that is a labour-sponsored investment fund corporation or labour-sponsored venture capital corporation under legislation of a jurisdiction of Canada and the dealer or adviser is the dealer or adviser of record for the client on the records of the issuer of the securities or the records of its investment fund manager

The additional statement must be provided at least once every three months. Since advisers will usually be required to provide statements under this section, we have incorporated the provision in subsection 14.14.1(3) that advisers must provide monthly statements if requested by a client.

If a registered dealer or adviser is required to deliver an account statement and an additional statement for the same period, it may choose to combine them into one statement or it may deliver them separately, provided the additional statement is delivered within 10 days of the account statement. This is a change from the 2012 Proposal which would have required information in an account statement and information in an additional statement to be combined in a single "client statement".

**Position cost information**

We are requiring registrants to include position cost information for each security position in the account statement and the additional statement, or in a separate document, under new section 14.14.2. Under the 2011 Proposal, we had proposed that original cost be provided as the comparator for market value. Under the 2012 Proposal, we made the change from original cost to book cost. After careful consideration, we have decided to allow registered firms to choose between original cost and book cost. Position cost may be integrated into the relevant account statement and additional statement or delivered in a separate document accompanying such statements or delivered within 10 days after the delivery of such statements, provided the market value of the securities is included with the position cost.

**Security holder statements**

Effective July 15, 2015, the requirement that was previously in subsection 14.14(3.1) for the delivery of a statement by an investment fund manager where there is no dealer or adviser of record will be moved to new section 14.15 and expanded to include the information required under the new provisions for additional statements and position cost that come into effect on that day.

**Scholarship plan dealer statements**

Effective July 15, 2015, the requirement that was previously in subsection 14.14(5) for the delivery of a statement by a scholarship plan dealer that is not registered in another dealer or adviser category will be moved to new section 14.16 and expanded to include the information required under the new provisions for additional statements and position cost that come into effect on that day. See “10. Scholarship plan dealers” for more information about changes specific to scholarship plan dealers.

## 8. REPORT ON CHARGES AND OTHER COMPENSATION

We have added section 14.17 which requires registered dealers and advisers to provide each client with an annual summary of all charges incurred by the client and all other compensation received by the registered firm that relates to the client’s account. Registrants are required to disclose the nature and amount of compensation received from third parties, such as trailing commissions and certain referral fees, that were generated as a result of the client’s account. The requirement to report compensation from debt securities transactions in a report on charges and other compensation mirrors the requirement applicable in trade confirmations.

## 9. INVESTMENT PERFORMANCE REPORT

We have added section 14.18 which requires registered dealers and advisers to provide clients with account performance reporting on an annual basis. The information to be provided in performance reports is set out in new section 14.19.

Performance reports are account-based. Securities reported in an additional statement must be included in the performance report for the account through which they were traded. However, consolidated performance reporting for more than one account of a client is permitted if the client has consented in writing and the consolidated report specifies which accounts and additional statement securities it consolidates.

**Opening market value, deposits and withdrawals**

Under paragraphs 14.19(1)(a) through (e), registered firms are required to disclose the opening market value of the account, the market value of deposits and transfers of cash and securities into the account, and the market value of withdrawals and transfers of cash and securities out of the account, for the latest 12-month period and since the inception of the account.

**Change in market value**

Paragraphs 14.19(1)(f), (g) and (h) provide formulae for the calculation of annual change in market value and cumulative change in market value. Registered firms can provide more detail about the activity in the client's account that has caused the change in value figure, as described in the Policy Statement.

**Percentage return calculation**

Under paragraph 14.19(1)(i), registered firms are required to provide the annualized total percentage return for the client's account or portfolio. Under the 2011 Proposal, we had proposed permitting registrants to choose between a time-weighted and dollar-weighted performance calculation method. Under the 2012 Proposal, we proposed to mandate that registrants use what we referred to as the dollar-weighted method for performance calculation in order to promote consistency and comparability in investor reporting from one registrant to another. The dollar-weighted method is also referred to as the money-weighted rate of return calculation method and we now refer to it by the latter name because it is more commonly used in the financial literature. We have decided to follow the 2012 Proposal and require registered dealers and advisers to use the money-weighted method (i.e. the dollar-weighted method) for performance calculation.

## 10. SCHOLARSHIP PLAN DEALERS

There is a new requirement under paragraph 14.2(2)(n) for scholarship plan dealers to include in their relationship disclosure information an explanation of any terms of a scholarship plan that if those terms are not met by the client or designated beneficiary might cause a loss of contributions, earnings or government contributions.

New section 14.16 is discussed above under "Scholarship plan dealer statements".

New subsection 14.19(4) sets out specific investment performance reporting requirements for scholarship plan dealers.

## 11. TRANSITION

Transition times of one, two or three years have been provided for most of the new requirements, taking into account the systems that registrants will need to build or adapt to accommodate the new requirements. Transition periods for key amendments are as follows (please see the *Regulation to amend Regulation 31-103 respecting registration requirements, exemptions and ongoing registrant obligations* published with this Notice for a complete listing of all transition periods):

- One year transition period
  - Paragraph 14.2(2)(m)
  - Paragraph 14.2(2)(n)
  - Section 14.2.1
  - Paragraphs 14.12(1)(b.1) and (c.1)
- Two year transition period
  - Section 14.11.1
  - Revised section 14.14
  - Section 14.14.1
  - Section 14.14.2
  - Section 14.15
  - Section 14.16
- Three year transition period
  - Section 14.1.1
  - Section 14.11.1, addition of requirement for investment performance report
  - Paragraph 14.12(1)(c), addition of deferred sales charge information
  - Section 14.17
  - Section 14.18

- Section 14.19
- Section 14.20

New requirements not listed above take effect on July 15, 2013.

Notwithstanding the transition periods outlined above, we encourage firms to consider early adoption of the Amendments.

Until the new provisions in section 14.14.1 come into effect on July 15, 2015, we continue to expect all registered dealers and registered advisers to provide account statements. Exempt market dealers should refer to *CSA Staff Notice 31-324 – Exempt market dealers and account statement requirements in Regulation 31-103 respecting Registration Requirements and Exemptions* for guidance until the implementation of s.14.14.1.

Note that applicable SRO requirements are not affected by these transition periods.

## 12. SAMPLE REPORTS

We have provided a sample report on charges and other compensation and a sample investment performance report in Appendices D and E, respectively, of the Policy Statement.

**ANNEX B**

**Summary of Comments and Responses on the 2012 Proposal**

This Annex summarizes the public comments we received on the 2012 Proposal and our responses to those comments.

**Categories of comments and single response**

In this document, we have consolidated and summarized the comments and our responses by the general theme of the comments. In general, we have not included comments already addressed in our responses to comments on the proposal published on June 22, 2011 (the 2011 Proposal).

**Contents of this summary**

This summary is organized into the following sections:

1. Costs and benefits
2. Fairness / Unlevel playing field
3. Harmonization
4. Trailing commission disclosure
5. Switch or change transactions
6. Foreign exchange rate
7. Foreign exchange spread
8. Client statements
9. Definition of “client” and “account”
10. Market valuation methodology
11. Position cost
12. Report on charges and other compensation
13. Fixed-income securities
14. Primary distributions
15. Percentage return calculation method

16. Scholarship plan dealers

17. Benchmarks

18. Transition

19. List of commenters

In this annex, we reference the sections and paragraphs of Regulation 31-103 published with this Notice except where otherwise indicated.

**Summary of comments and responses**

## 1. Costs and benefits

There were a variety of comments to the effect that we should have conducted a quantitative cost benefit analysis (CBA) before making our proposals. Most of these comments focused on the proposal to require disclosure of the dollar amount of trailing commissions paid to a registered firm.

A quantitative CBA is not a prerequisite for rule-making.

We have made a qualitative assessment of the costs and benefits of requiring dollar disclosure of trailing commissions based on research as to what investors understand about trailing commissions. A large proportion of retail clients are either unaware of trailing commissions or have a very limited understanding of them. At the same time, trailing commissions are the dominant form of compensation for selling mutual funds today. It is therefore essential that clients be provided with direct, client-specific information about the amount of trailing commissions paid in respect of their investments.

Information about the costs of goods and services and a seller's incentives is fundamental. As such, we regard providing that information as a cost of doing business and not something that should be passed on to clients.

We think the same analysis applies in respect of comprehensive reporting on the securities a client has purchased or sold through a registrant, and in respect of investment performance reporting.

We acknowledge that there will be one-time system building costs associated with the new reporting requirements. We have provided unusually long transition periods for some of the new requirements in order to ensure there is sufficient time for the building and implementation of these systems. We note that regardless of the requirement to report trailing commissions, registered dealers and advisers would in any event be required to build systems to provide the new annual report on charges and other compensation. We do not think the costs of including trailing commission information in the annual report will be significant after the necessary systems have been built.

It is also worth noting that other CSA initiatives are providing registered firms, particularly those in the mutual fund industry, with opportunities for reductions in ongoing costs. These include the availability of electronic delivery options as an alternative to printing and mailing, and plans for the replacement of the mutual fund prospectus with the Fund Facts document.

**2. Fairness / Unlevel playing field**

We received comments from the mutual fund industry, similar to those made on the 2011 Proposal, that the 2012 Proposal would result in an uneven playing field for registered firms, as investment products that do not fall under the jurisdiction of the CSA will not be subject to comparable cost disclosure and performance reporting. We reiterate that we can only make rules within our jurisdiction. The fact that other segments of the financial industry will not have comparable requirements for non-securities investments is not a reason to reduce the level of disclosure that we think is necessary for those who invest in securities.

Several commenters called for the CSA to work with other financial regulators, departments of finance and other government departments and agencies to promote a level playing field for all sellers of various investment products. We acknowledge that it would be in the interest of investors if comparable cost and performance transparency could be achieved for all investment products. CSA members are communicating with other financial regulators and government departments and agencies to raise this issue.

There were also some comments suggesting that investors will be misled about the relative costs of alternative investments compared to securities. Other commenters asserted this might lead some registrants to recommend alternative investments over securities. We would remind such registrants that they can explain the costs associated with various investment products and they have the duty to act fairly, honestly and in good faith toward clients.

**3. Harmonization**

We received comments concerning the importance of harmonizing the Regulation with member rules of the securities industry self-regulatory organizations (SROs), which are the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA).

We made revisions to the 2012 Proposal in several ways to be more closely harmonized with SRO requirements including:

- changing the trade confirmation requirements for debt securities to more closely resemble the approach taken in current IIROC requirements

- breaking the proposed “client statement” into constituent elements of account statement, additional statement and position cost information, rather than requiring their consolidation and delivery as a single document

- allowing the use of original cost for position cost information

- providing exemptions for permitted clients that are not individuals from the position cost information requirement (IIROC exempts “Institutional Customers”, which is a similar but not identical category)

We continue to work with the SROs to ensure that their member requirements will be materially harmonized with the common baseline for registrants set out in the Regulation.

**4. Trailing commission disclosure**

Many mutual fund industry members continued to express their opposition to the requirement for disclosure of dollar amounts of trailing commissions. We have considered these comments again and disagree for the reasons set out above under “Costs and benefits”.

We received comments suggesting that mutual fund companies with in-house distribution might change their distribution compensation system to eliminate trailing commissions, making other mutual fund dealers, who continue to rely on trailing commissions, seem more costly to investors. The CSA objective is to make disclosure of key information more transparent and by doing so, we are neither supporting nor discouraging the use of trailing commissions by making disclosure better. If problems emerge in other compensation models we will consider appropriate action.

Some commenters suggested that investors might think the trailing commission is charged on top of the management fee of a product. We have revised the notification to make it clear that trailing commissions do not represent an additional cost to investors. We have also revised the Policy Statement to remind registered firms and their representatives that they can explain their compensation model in more detail in disclosure documents or in face-to face meetings with their clients.

We have revised the definition of “trailing commission” in section 1.1 of Regulation 31-103 to be more technically accurate.

We received requests for more specific requirements with respect to investment fund managers’ obligation under subsection 14.1.1 to provide dealers and advisers with information concerning charges deducted from the net asset value of securities upon their redemption and trailing commissions in order for dealers and advisers selling their products to be able to meet client reporting obligations. This is a principles based requirement. The substance of the dealers’ and advisers’ obligation is clearly set out in paragraphs 14.12(1)(c) and 14.17(1)(h). Investment fund managers and the dealers and advisers who sell their products will have to work cooperatively with one another and, in many cases, with FundServ or other service providers. The systems work necessary for different investment fund managers to ensure the distributors of their products will be able to satisfy their client reporting obligations will vary. Some of what is needed might only become apparent to information technology specialists during the course of developing the new systems. We will work with industry to respond pragmatically to any needs for guidance that may emerge as this process progresses.

We have provided a transition period of three years in order for investment fund managers, dealers and advisers to have sufficient time to build and test reporting systems to comply with the new requirements. We expect investment fund managers, dealers and advisers to be fully compliant at the end of the three year transition period, so that trade confirmations will include the new information about various charges immediately after the transition period ends and the new information will be included in clients' reports on charges and other compensation for the period that includes the first day after the end of the transition period.

**5. Switch or change transactions**

We received comments that the proposed language in section 14.2.1 of the Policy Statement regarding switch transactions is misleading and highlights practices that are not problematic, while ignoring other practices that might be. Some commenters added that the proposed language does not belong in the Policy Statement but rather in SRO rules.

We have clarified the language in the Policy Statement. We consider clear and complete disclosure of all charges, incentives and implications associated with a switch or change transaction is necessary given that mutual fund compensation structures are not clearly understood by many investors. We regard it as a fundamental issue linked to a registrant's duty to act fairly, honestly and in good faith. We have kept the language, as clarified, in the Policy Statement as not all registered dealers are required to be members of an SRO.

**6. Foreign exchange rate**

One comment letter suggested that the foreign exchange rate used in calculating the market value of non-Canadian dollar denominated securities should be indicated on statements. We consider this disclosure to be a best practice and we have revised the Policy Statement to encourage registrants to disclose the foreign exchange rate on account or additional statements.

**7. Foreign exchange spread**

We have dropped foreign exchange spreads from the examples of "transaction charges" that were included in the Policy Statement guidance under the 2012 Proposal. We accept the comments to the effect that it is often not possible to provide the exact amount of foreign exchange spreads on a transaction-by-transaction basis, and that calculating an approximate dollar spread would be complicated and costly, with results that would not always be accurate. We have added to the Policy Statement a statement that although we do not consider foreign exchange spreads to be a transaction charge, we encourage registered firms to include a general notification in trade confirmations and reports on charges and other compensation that the firm may have incurred a gain or loss from a foreign exchange transaction as a best practice.

## 8. Client statements

We received comments that, since investment funds managers already send security holder statements directly to investors, it will be duplicative and confusing if the dealer or adviser provides the same information to their clients. When delivering statements to their security holders, except for those statements delivered under section 14.15, investment fund managers are not complying with any regulatory requirement. We think that it is entirely appropriate that the responsibility to report to a client be that of their dealer or adviser and not fragmented among the fund families in which the client may have invested.

We disagree with comments that information on securities not held or controlled by a dealer or adviser that the 2012 Proposals would have included in a "client statement" would be unreliable. We have limited the new requirement to securities that a registered firm can reliably verify its clients continue to own. The requirements to include these securities in the new additional statement and in the new performance report, and to provide a position cost for them, will apply two years and three years, respectively, after the Amendments come into force. There is no requirement to gather information relating to earlier periods. For performance reports and position cost information, we provide that market value can be used to establish the initial valuation as of the implementation date.

We received some comments that the delivery of current account statements would be delayed by integrating it with the required new information in the proposed client statement because the new information will have to come from external sources. We agree with the comments and have revised our proposal to allow registered firms to provide the new information to clients separately from the current account statement, at their discretion. We will require the new information about client name securities to be delivered at least quarterly, and within not more than 10 days of the delivery of the account statement.

We encourage firms to work to the point where they will have systems that will enable the new statements to be produced in a timely manner or the two documents to be sent together.

## 9. Definition of "client" and "account"

We disagree with comments that requested we include in Regulation 31-103 a definition of the terms "client" and "account" in order to clarify who and how the disclosure and reporting should be provided. The terms "client" and "account" are common terms that are used often and repeatedly throughout securities legislation and rules. Our intent in using those terms in the 2012 Proposal in the context of cost disclosure and performance reporting is the plain language meaning.

## 10. Market valuation methodology

We received some comment letters that suggested the proposed market valuation methodology is not consistent with the Canadian Generally Accepted Accounting Principles (GAAP), and is overly prescriptive as compared to International Financial Reporting Standards (IFRS). It was also suggested that the methodology used be consistent with Canadian GAAP in order to reflect the approach taken in the Regulation in respect of working capital calculation and financial reporting and section 2.6 of National Regulation 81-106 *Investment Fund Continuous Disclosure*.

We have prescribed a hierarchy of valuation methods that we think is a reasonable approach to ensuring that the market values of securities being reported to investors are reflective of their current values. We are addressing market value determination only for the specific purpose of client reporting. While the prescribed approach does include concepts from IFRS, it also takes into account that reporting an accounting valuation of a security for which no market exists may be misleading for investors.

Some comment letters expressed concern that the use of last bid price for long positions and last ask price for short positions as market value is inappropriate, overly prescriptive and not in accordance with Canadian GAAP. One specific concern was that these values may be misleading to clients as there could be large bid/ask deviations that do not reflect the market value of the security. Several comment letters suggested that the current last trade calculation is a simpler, established and more appropriate methodology for valuing securities for the purpose of client reporting.

We acknowledge that there are practical issues with the use of last bid/ask price, and that it may not always result in a market value that is reflective of the current value of a security. However, the methodology that we have prescribed is currently in use by some registrants and allows for adjustment to the last bid/ask price should a registered firm deem it necessary to accurately reflect the current value of the security. We expect registrants to exercise professional judgement in applying the methodology and take heed of the requirement that market values should be reflective of the current value of a security at the date of client reporting.

**11. Position cost**

We received several comment letters in support of book cost as the appropriate method for presenting position cost, as set out in the 2012 Proposals. A number of other commenters advocated the use of original cost, and several others were in favour of allowing registered firms the flexibility to choose between presenting original cost and book cost.

We have concluded that neither method for determining position cost is clearly more beneficial to investors than the other. Consequently, we do not think it would be appropriate to mandate one as the only acceptable method.

**12. Report on charges and other compensation**

In response to comments concerning the scope of the part of the 2012 Proposals that is now addressed in paragraph 14.17(1)(g), we have clarified that the only referral arrangements that must be included in the annual report on charges and other compensation are those made to the registered firm or any of its registered individuals by a securities issuer or another registrant in relation to registerable services to the client during the period covered by the report.

We were asked by one commenter whether portfolio managers who manage their clients' money through pooled funds would be required to look through the pooled fund to determine how much of the pooled funds' management fee related to units held by its clients. The definition of operating charge is specific to the account and is not a product related fee so the portfolio manager would not be required to include a fund management fee in the report on charges and other compensation that it delivers to a client. However, if a portfolio manager's compensation model is one that relies on fund management fees rather than the more usual portfolio management fee, we would expect the portfolio manager to ensure that its clients fully understand the basis on which the firm is compensated for its advising services and report those charges to its clients on an annual basis, in keeping with the duty to deal with clients fairly, honestly and in good faith.

One commenter proposed an exemption from the requirement to provide clients with an annual report on charges or other compensation for employee programs which offer a firm's proprietary funds to employees through an ongoing compensation program. We think relief may be appropriate in limited circumstances, such as where all of the employees in the plan already have knowledge of or ready access to the relevant information relating to the performance of the pooled funds. However, we do not believe this will always be the case for employee programs involving proprietary funds. We will therefore consider exemptions on the basis of discretionary relief applications.

## 13. Fixed-income securities

In response to our request for comments on the feasibility of requiring disclosure of all of the compensation and/or income earned by registered firms from fixed-income transactions, we received comments from industry that such disclosure would not be feasible or appropriate. Other commenters said that this information would be desirable.

At the same time, a number of commenters submitted that the so-called gross (retail) commission paid to dealer firms is readily available information. Commenters also argued that the disclosure of the dollar amount of compensation paid to a dealing representative required under our 2012 Proposal could be misleading to retail clients because it may represent only a percentage of the commission received by the dealer firm on a fixed-income transaction. We agree and have revised the requirement accordingly to require disclosure at the firm level. This approach is also consistent with the new requirement for trailing commission disclosure.

The revised requirement provides registrants the following two options. Registrants may disclose the total dollar amount of its compensation taken on the trade (which may consist of any mark-up or mark-down, commission or other service charge) or, alternatively, the total dollar amount of commission, if any, and if the registrant applied a mark-up or mark-down or any service charge other than a commission, a prescribed general notification.

The revised requirement, including the prescribed general notification, is substantially harmonized with IIROC's equivalent requirement, except that it adds the requirement to disclose commissions if a firm does not opt to provide the total dollar amount of compensation.

Some commenters requested that we provide a definition of fixed-income security and clarify the types of products which would not be considered fixed-income securities. We have clarified Regulation 31-103 by replacing “fixed-income securities” with “debt securities”, a defined term under securities legislation.

## 14. Primary distributions

There were comments concerning the extent to which payments to dealers or advisers in respect of equity initial offerings or primary offerings of fixed income securities might be included in the new requirements for trade confirmations and reports on charges and other compensation.

One-time payments to a registered dealer or registered adviser in connection with an initial distribution of securities from an issuer or other party other than an investor who is a client of the dealer or adviser may relate to services other than services the dealer or adviser provides to the client. For example, an issuer might pay for investment banking service. We have drafted sections 14.12 and 14.17 and the relevant definitions to ensure that payments of this kind would not be required to be disclosed to a client. On the other hand, commissions charged to a client or ongoing payments in relation to the client’s investments within definition of trailing commission would be required to be disclosed to the client.

## 15. Percentage return calculation method

We received many comments concerning the percentage return calculation methodology. The majority of commenters recommended allowing registered firms to determine the most appropriate calculation methodology for performance reporting, while a number of commenters were in favour of mandating the money weighted rate of return (MWRR) methodology (also known as the dollar weighted methodology), as set out in the 2012 Proposal. Some of the commenters would prefer the time weighted rate of return (TWRR) method, should we mandate the use of one particular methodology. A small number of commenters argued performance reports should include percentage returns based on both methodologies.

We have decided to require the use of the MWRR method because we have concluded that it is the better choice for investors. This project aims to provide performance information that is useful to a client as a measure of their progress toward their investing goals. Research points strongly toward the value of measures that retail investors can relate directly to their own experience. We think all investors share an interest in performance figures that focus on actual returns in their account, not the notional performance of their registrant. Presenting the MWRR of an account enables investors to directly measure how they are progressing toward their goals. Another goal of this project is to encourage communication between clients and their dealers and advisers. The impact of a client’s choices about money flows in and out of the account is reflected with MWRR. Registrants can use this information to educate clients about the effects of their decisions about moving money in and out of their accounts. These conversations will also help clients assess the value of the advice they receive.

Registered firms that are already providing performance reports using TWRR commented that a switch to MWRR could create confusion for investors. We acknowledge this but point to the opportunity to prepare for implementation of the new requirement over a three year period. Also, nothing prohibits a firm from providing percentage returns calculated using the TWRR method in addition to the required percentage returns calculated on a MWRR basis.

Some comment letters mentioned that the proposed requirement to use MWRR is contradictory to the standards established and administered by the CFA Institute, known as Global Investment Performance Standards (GIPS) which requires the use of TWRR. The goal of the GIPS standards is to allow prospective clients to make a more informed decision regarding the selection of an investment manager, while our goal is to show clients how their accounts have performed.

There was a suggestion that calculating percentage returns using the MWRR should be limited to 10 years, as reporting performance for periods beyond 10 years may have little value for investors, and will pose a very significant technological challenge for registered firms. We have not modified the proposed requirement because we think performance information since inception will be valuable to investors and we do not think providing this information for periods greater than 10 years will be problematic.

Some commenters recommended Regulation 31-103 define a specific MWRR method that would be acceptable, and there were requests for confirmation that the Modified Dietz method or other approximation techniques would comply with the MWRR requirement. We have decided not to define acceptable methodologies within the MWRR. We have provided that for these purposes, a firm may use a methodology that is generally accepted in the securities industry. We do not think that Modified Dietz or other approximation techniques are any longer generally accepted.

**16. Scholarship plan dealers**

There were comments suggesting that the disclosure required under the 2012 Proposal would duplicate information already provided to clients under existing requirements. It was suggested that the relationship disclosure information delivered to investors at account opening should simply refer to the scholarship plan prospectus and/or plan summary.

There is in fact little overlap between the reporting requirements in our proposals and existing disclosure requirements applicable to scholarship plans, and we do not think one-time product purchase disclosure is sufficient in itself for an ongoing investment of this kind. We have tailored reporting requirements for scholarship plan dealers to the unique features of scholarship plans. Pre-purchase disclosure in writing of the terms of a scholarship plan, including disclosure of the front-loaded fees, the risks of the plan and the potential amount of income if invested to maturity, provides investors with essential information. This pre-purchase disclosure may be complied with by providing the summary document prepared by scholarship plans if it contains the required pre-purchase information.

There was a suggestion that an investor should receive an initial investment statement, including disclosure of the costs and conditions of the plan, within 30 days of account opening instead of pre-purchase disclosure, permitting the investor to use the information to clarify the terms and any misunderstandings within the common 60 day withdrawal right period. We think that, in terms of investor protection, it is better to have a well-informed investor prior to the opening of an account.

One commenter did not support disclosure of the amount the investor's beneficiary may receive if the investor stays with the plan to maturity, as this amount could depend on too many unknown factors. We disagree with this position. The maximum amount the beneficiary could be entitled to in isolation could be misleading, but this amount will be provided with a summary of the plan terms, disclosure of any fees, investor options if plan payments are discontinued, and the total amount invested. Together, this information will provide investors in scholarship plans with basic information to determine what they have paid and how their investment will or has performed.

We disagree with the request that the guidance on paragraph 14.2(2)(n) in the Policy Statement should be part of Regulation 31-103 and that its language be modified to include reference to the prospectus for a description of the options available to an investor who cannot maintain prescribed payments. Regulation 31-103 sets out minimum requirements and a registrant may choose to add a reference to the prospectus. However, it would not be satisfactory to simply direct a client to refer to the prospectus.

Other commenters stated that disclosure of the risks and features of scholarship plans is not sufficient on its own. One commenter recommended the CSA to consider substantial regulation in this area, while the other commenter suggested that scholarship plans should be phased out entirely. We cannot address these comments as they are outside the scope of this CSA project.

## 17. Benchmarks

After careful consideration, we have come to agree with commenters that recommended we drop the Policy Statement guidance in the 2012 Proposals that encouraged firms to include an historical five-year GIC rate in performance reports. We have been persuaded that using such a rate may be inconsistent with the guidance that registrants should use benchmarks that are reasonably reflective of the composition of the investor's portfolio so as to ensure that a relevant comparison of performance is presented. Use of a five-year GIC as a reference point for discussions about the risk-return proposition may be appropriate for many clients, but there may be others for whom it would not.

## 18. Transition

The 2011 Proposal provided for an implementation period of two years for most of the new requirements. Many industry commenters then argued for an implementation period of at least three years, while investor advocates generally stated that one year would be sufficient. We were persuaded that three years would be a necessary transition period for some of the proposed new reporting requirements and provided for it in the 2012 Proposal. We do not agree with suggestions in the comments on the 2012 Proposal that even more time would be required. The transition period for investment fund managers is discussed above under "Costs and benefits".

We acknowledge the comments from others that some of the transition periods are generous. We would also like to see the proposed new disclosures in the hands of investors as soon as possible, but we have to take into consideration the time needed for the industry to develop, test and implement the necessary systems. We encourage registered firms to implement new reporting requirements before the end of transition periods if possible.

## 19. List of commenters

We received submissions from the following 65 commenters:

1. Advocis
2. AGF Investments Inc.
3. Alternative Investment Management Association
4. Armstrong & Quaile Assoc. Inc.
5. Association of Canadian Compliance Professionals
6. B2B Bank
7. Borden Ladner Gervais LLP
8. Canadian Foundation for Advancement of Investor Rights
9. Canadian GIPS Council
10. Canadian Imperial Bank of Commerce
11. Canfin Magellan Investments Inc.
12. Capital International Asset Management (Canada), Inc.
13. CI Financial Corp.
14. Cripps, James B. F.
15. Dundee Private Investors Inc.
16. DWM Securities Inc.
17. Edward Jones
18. Federation of Mutual Fund Dealers

19. Fidelity Investments Canada ULC

20. Franklin Templeton Investments Corp.

21. Greystone Managed Investments Inc.

22. Groupe Cloutier Investissements Inc.

23. Heathbridge Capital Management Ltd.

24. Highstreet Asset Management Inc.

25. IA Clarington Investments Inc.

26. Independent Financial Brokers of Canada

27. Independent Planning Group Inc.

28. ING Direct Funds Limited

29. Invesco Canada Ltd.

30. Investment Industry Association of Canada

31. Investment Planning Counsel Inc.

32. Investor Advisory Panel

33. Investors Group Inc.

34. Kenmar Associates

35. Killoran, Joe

36. Labbé, Jean-François G.

37. Lucyk, Christine

38. MacKenzie Financial Corporation

39. Manulife Securities Incorporated

40. MD Physician Services Inc. and MD Management Ltd.

41. MICA Capital inc.

42. Mouvement des caisses Desjardins

43. National Bank Securities Inc.

44. Pacific Spirit Investment Management Inc.

45. PEAK Investment Services Inc.

46. Porter, Hamish

47. Portfolio Management Association of Canada

48. Portfolio Strategies Corporation

49. Primerica (PFSL Investments Canada Ltd. and PFSL Fund Management Ltd.)

50. Quadrus Investment Services Ltd.

51. Royal Bank of Canada (RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc., RBC Global Asset Management Inc., RBC Phillips, Hager & North Investment Counsel Inc., and Phillips, Hager & North Investment Funds Ltd.)

52. RESP Dealers Association of Canada

53. Rogers Group Investment Advisors Ltd.

54. Scotia Asset Management L.P.

55. Scotia Capital Inc.

56. Scotia Securities Inc.

57. Steadyhand Investment Funds

58. Sun Life Financial Investment Services (Canada) Inc.

59. Sun Life Global Investments (Canada) Inc.

60. TD Asset Management Inc.

61. The Canadian Advocacy Council for Canadian CFA Institute Societies

62. The Investment Funds Institute of Canada

63. The Omega Foundation

64. Tradex Management Inc.

65. Young, Duff