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Borden Ladner Gervais

Canadian Securities Administrators Finalize Rules Requiring Enhanced Account Level Disclosure by Registrants: Effective July 15, 2013

On July 15, 2013, amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and its Companion Policy — referred to by the Canadian Securities Administrators as the second stage of the CSA's long-standing "client relationship model" project (CRM) – will become effective. The new CRM disclosure and reporting requirements will be phased-in over a three year period, with certain changes effective immediately.

These rule amendments (the CRM Amendments) build on the client "relationship disclosure information" currently mandated under NI 31-103 (RDI), and will require a registered firm to provide disclosure – at specified times – to clients on an account-by-account basis of:

- Account charges, including transaction charges, levied by the firm.
- Charges that may be borne (directly or indirectly) by the client if the client invests in certain securities – for example, the CSA expect some discussion about the costs of investing in mutual funds.
- Compensation received by the firm – or its representatives – in respect of the client's account – with a focus on trailing commissions and compensation relating to debt security transactions.
- Performance of the investments held in the account.

Mandated information tailored to each client (and each account) will be required to be provided – either orally or in writing – on account opening, on a pre-trade basis, in trade confirmations and on a quarterly and annual basis. Much of the new disclosure is not required to be given to institutional "permitted clients". The transition periods for the new requirements range from one to three years, which means that CRM will be fully in force for all registrants by July 15, 2016.

The CRM Amendments have been developed by the CSA over a period of several years, with the last version of the rule amendments being published for comment in mid-June 2012. See *Canadian Securities Administrators Revise Proposals for Enhanced Account Level Disclosure and Investment Performance Reporting by Registrants* Investment Management Bulletin July 2012 Borden Ladner Gervais LLP. The CSA have made changes from the June 2012 proposals, but none are considered to be material by the CSA, which means that the rules are no longer subject to industry comment. The rules are very complex, with nuanced variations depending on circumstances, and must be carefully considered, along with the CSA's expectations for compliance as set out in the Companion Policy. Many of the amendments to the rules and the Companion Policy are substantially different (in language used and effect) from what was previously published for comment. We note also that the CSA did not change certain controversial and difficult requirements, notwithstanding extensive industry commentary.

It remains for the self-regulatory organizations – the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC) to determine what changes are required to their respective rules in order to harmonize them with the CRM Amendments.

CRM — At a Glance

CRM Requirement	Changes from 2012 Proposals	Transition
Enhanced relationship disclosure information (RDI) at *account opening* including: • general description of benchmarks and options available, if any, from the firm for benchmark information • specific disclosure for scholarship plan dealers	The terms "operating charge" and "transaction charge" have been clarified to refer to amounts charged to clients by the registered firm. These terms are important for RDI, since the RDI must contain a complete description of both types of charges. Any new operating charge or increased operating charge needs 60 days' advance written notice to clients.	Wording and definitional amendments effective July 15, 2013. 60-day notice provision of new or increased operating charges effective July 15, 2013. July 15, 2014 for new disclosure requirements.
Oral or written *pre-trade* disclosure of: • the "charges" the client will be required to pay in respect of the purchase or sale of a security – with particular focus on mutual funds • the deferred sales charges (DSC) that may be charged on redemption of mutual funds (including the fee schedule) • whether the firm will receive trailing commissions in respect of the security being acquired	—	July 15, 2014

Enhanced *trade confirmation* disclosure – including • the annual "yield" or any debt securities • specified disclosure regarding dealer compensation in connection with debt securities • the amount of each transaction charge, DSC or "other charge" for the transaction and total amount of such charges Investment fund managers mandated to provide other registrants with information about DSC and any other charges deducted from the NAV of mutual funds "within a reasonable period of time".	Clarifications regarding the disclosure to be provided in respect of debt securities. No further clarity on the requirement that investment fund managers provide the information required to dealers, other than to coordinate the transition periods. No clarity on the meaning of "other charges" in the context of transactions.	July 15, 2014 for debt security disclosure. July 15, 2016 for disclosure on charges, including DSC and for the requirement that investment fund managers provide this information.
Nominee name securities - quarterly account statements (monthly in certain prescribed circumstances) with enhancements to existing requirements, including: • "market value" for each security – with a complex definition of "market value", which may require additional disclosure in statements • identification of which securities	New complex definition of how to calculate market value, with new disclosure requirements. New definition of "original cost", with definition of "book cost". Position cost can be original cost or book cost – this information can be delivered separately within 10 days of the other statement(s). Clarifications on how registered firms are to handle securities held in nominee	July 15, 2015 for new disclosure requirements.

are subject to DSC • name of applicable investor protection fund • specified information about the "cost" of each position, which may be either book cost or original cost. This information can be provided separately (and sent 10 days later) or combined with this statement The content of quarterly account statements depends on whether the securities are held in nominee (dealer name) or client name – see below.	name and client name for reporting purposes.	
Client name securities - quarterly account statements (monthly in certain prescribed circumstances) with disclosure on: • "market value" for each security – with complex definition of "market value", which may require additional disclosure in statements • name of the party that holds or controls each security and a description of how it is held	New complex definition of how to calculate market value, with new disclosure requirements. New definition of "original cost", with definition of "book cost". Position cost can be original cost or book cost – this can be delivered separately within 10 days of the other statement(s). Clarifications on how statements are to be provided where clients have securities held in nominee name and client name, including the	July 15, 2015 for new disclosure requirements, including for fund managers.

• identification of which securities are subject to DSC • name of applicable investor protection fund • specified information about the "cost" of each position, which may be either book cost or original cost. This information can be provided separately (and sent 10 days later) or combined with this statement Concept of when securities are considered to be in client name is provided. If client has both types of securities (nominee and client name), then firm can combine information in one statement, keep them separate and deliver the statement covering client name securities within 10 days of the period end. Fund managers must comply with new requirements for orphan accounts at least annually.	ability to send client name security statements 10 days later than the nominee name statement. Clarifications on when securities are considered to be held in client name.	
Annual report of "charges" and compensation – mandated disclosure to include: • firm's current "operating charges" that	Additional clarifications on debt security disclosure. Additional clarifications on how to provide this information for securities held in nominee name and securities held in client name.	July 15, 2016

apply to the account • total amount of each type of “operating charge” and “transaction charge” paid by the client for previous year, along with the total aggregate amounts • specified disclosure about compensation paid in connection with debt securities • specified disclosure about commissions payable by scholarship plan subscribers • total amount of each type of payment to the firm or any of its registered individuals by any person or company in relation to the client, with an explanation of each type of payment • amount of trailing commissions received in respect of the account, with specified mandated disclosure.		

Investment fund managers mandated to provide other registrants with information about DSC and trailing commissions within a "reasonable period of time". Sample Report on Charges and Compensation provided as part of Companion Policy, but no specific format mandated. Information regarding securities in client name must be reported on separately from securities reported on in nominee name.		
Annual investment performance report – mandated disclosure to include • specified information, including market value at the beginning and end of the period, market value of money and securities transferred in or out of account, annual change in value, the cumulative change in value, annualized total percentage return – all as at one, three, five and 10 year periods (and since inception if less than 10 years) • specified disclosure in	Special clarifications on requirements for performance calculations for accounts that were opened before July 15, 2015 (previously the CSA suggested longer transition periods). Additional clarifications on how to report performance for securities held in nominee name and securities held in client name.	July 15, 2016

respect of scholarship plan investments. Sample Report on Investment Performance provided as part of Companion Policy, but no specific format mandated. Special considerations for accounts opened before July 15, 2015. Information regarding securities in client name must be reported on separately from securities reported on in nominee name.		

Impact of the CRM Amendments

All registered firms, including in certain circumstances, a registered investment fund manager, will be subject to new disclosure and reporting requirements that will be phased in over three years. However, some of the new disclosure and reporting does not need to be provided to "permitted clients" that are not individuals (essentially, institutional investors). And, only limited information is required to be delivered by a dealer whose relationship with a client is limited to executing trades as directed by a registered adviser (portfolio manager) acting for the client. The CSA's focus is on "retail" investors, with an assumption that an individual (no matter how experienced, knowledgeable or investment savvy) generally must always receive the mandated information.

As we pointed out with the earlier proposed versions of the CRM Amendments, for the most part, the CSA do not address the extensive work of the past few years to create and enhance disclosure in Fund Facts documents and other disclosure documents relating to mutual funds and other investment funds, where some of the required information is already clearly set out. Except in relation to the required "pre-trade" disclosure, which can be provided verbally, the required written disclosure is supplemental to the Fund Facts and other disclosure documents and cannot be satisfied by delivery of these documents.

The CRM Amendments will have a significant impact on all registered firms, including those dealers that are members of the Mutual Fund Dealers Association of Canada (the MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC). The CSA consider the changes made to finalize the CRM Amendments make many of the requirements of NI 31-103 more closely harmonized with existing MFDA and IIROC requirements. However, the CSA also indicated they will "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 NI 31-103". Given the suspension of some of the current SRO rules, this means more changes ahead for SRO members.

In light of the other recently-announced initiatives of the CSA to consider whether a "best interest" standard should be mandated for registered dealers and advisers as well as the regulatory issues and options regarding mutual fund fees[1], we consider that it is essential for the CSA to carry out further research to consider whether investors are better informed by the CRM Amendments once the requirements are fully implemented and before any other

initiative is adopted. This should include determining whether investors understand what they should be doing with the information provided, and whether they are better informed by the various streams of disclosure. We view the CRM Amendments, and the other related initiatives, to be different methods of dealing with the same central regulatory concerns; namely that retail clients should be given the tools and have the regulatory protections available to allow them to make informed investing choices and to have increased protections to achieve their investment goals.

Amendments to Relationship Disclosure Information

The CRM Amendments modify the existing rules requiring RDI to be provided to clients of registered firms:

- New defined terms for "operating charge" and "transaction charge" – these changes are effective July 15, 2013 and clarify the current understanding of the existing requirements.
- RDI will be required to contain a general explanation about benchmarks and whether the firm offers any options for benchmark reporting to clients – this new disclosure will be required to be provided on and after July 15, 2014.
- Additional disclosure requirements apply to scholarship plan dealers, concerning the conditions applicable to education assistance payments, much of this information is already provided by these dealers in the prospectus (as of May 31, 2013, with the new Plan Summary), but the new requirements for RDI come into effect on July 15, 2014.

Consistent with current SRO requirements, under the CRM Amendments registered firms, will be required to provide their clients with 60 days prior written notice of any new or increased operating charge – this new requirement will be effective July 15, 2013. This requirement will apply regardless of the terms of contractual arrangements that may otherwise allow changes to such charges with shorter notice or without notice.

Extensive and detailed guidance (some labelled by the CSA as "best practices") on the information that must be provided in the RDI by registered firms is provided in the revised Companion Policy (the revisions come into effect on the implementation of the corresponding changes to NI 31-103). This includes the following "best practices" concerning RDI:

- The CSA encourage RDI to provide information about the charges a client might pay during the course of holding a particular investment. Their particular focus is on mutual funds. If a client will be investing in mutual funds not only must disclosure about the charges associated with a mutual fund investment be provided, the RDI must also explain how these charges "may affect the investment". It is clear that this disclosure may be general information, although the CSA expect that firms will provide specific information about the nature and amount of the actual charges that will apply as part of the pre-trade disclosure requirements discussed below.
- The disclosure applicable to performance benchmarks should include a general description of how investment performance benchmarks might be used to assess the performance of a client's investments as well as any options available to the client to obtain information about benchmarks from the firm. While there is no requirement for registered firms to use benchmarks to compare to actual account performance, the CSA "encourage firms to do so as a best practice".

Pre-Trade/Recommendation Disclosure

Registered firms will be required to provide clients (other than "permitted clients" that are not individuals or managed account clients) with
information about the "charges" in connection with each purchase or sale to be made for the account on a pre-trade/recommendation basis. Dealers who purchase or sell securities for a client only as directed by a registered adviser acting for the client are not required to provide this information. In addition to a description of "charges" that will apply to the particular transaction, applicable firms must tell the client about:

- The amount of the DSC that may be payable by the client on a future redemption of the security and provide the fee schedule that will apply.
- Whether the firm will receive trailing commissions in respect of the recommended security.
- Any compensation the firm will receive on the trade of a debt security.

The CSA explain in the Companion Policy that this disclosure is not required to be provided in writing; oral disclosure is sufficient and certain of this disclosure can be satisfied, as applicable, by directing the client to the disclosure provided for in the Fund Facts or prospectus documents.

It is clear, however, that the CSA expect there to be a real conversation between a representative (advisor) and his or her client about these issues before a recommendation can be agreed to by the client and a trade made. It will be vital for firms to implement systems to document that this information was provided to clients before the trades are placed.

These disclosure requirements become effective on July 15, 2014.

Enhanced Disclosure on Trade Confirmations

Registered dealers will be required to provide the following additional disclosure on trade confirmations:

- The annual yield of any debt security purchased. The term "annual yield" is not defined, but the CSA provide guidance on what they consider would be appropriate disclosure in the Companion Policy. This disclosure obligation becomes effective July 15, 2014.
- For a purchase or sale of a debt security either
    - the total dollar amount of compensation taken by the firm on the trade (which may consist of any mark-up or mark-down, commission or other service charge), or
    - the total dollar amount of any commission paid to the firm and, if the firm applied a mark-up or mark-down or any service charge other than a commission, a prescribed general notification (subject to a one year transition period).

This disclosure obligation becomes effective July 15, 2014.

- The exact amount of each transaction charge, DSC or "other charge" in connection with each transaction, as well as the total amount charged. There is no further guidance on what might constitute an "other charge", but it is clear that "charges" include anything that would get deducted from the investment being made or the sale proceeds being paid out to the client. Fund managers will be required to provide this information to other registrants, as necessary, within a "reasonable time period". The CSA are clearly leaving the method of complying with these provisions up to the industry to sort out, and recognize

that organizations such as FundSERV Inc. may be able to play an important part in facilitating registrants' ability to meet these requirements. These requirements become effective July 15, 2016.

Expanded Account Statements and Reports

The CRM Amendments not only enhance the information that must be provided to clients on account statements, but also increase the variations of account statements that registered firms will be required to provide, as well as modify the timing of such statements. Different account statements are required depending on whether securities are held in nominee name or in client name:

- *Regular quarterly account statements.* All registrants will be required to provide quarterly client statements at a minimum (monthly if requested by the client). This clarified obligation becomes effective July 15, 2013.
- *Enhanced quarterly account statements –securities held in nominee name.* The enhanced disclosure requirements for these statements become effective on July 15, 2015.
- *Enhanced quarterly account statements –securities held in client name.* A statement separate from (but could be combined with) the statements confirming information about securities held in nominee name is required in respect of securities held by a party other than the dealer or adviser in circumstances where the dealer or adviser can readily verify what a client owns (client name). These statements can be provided separately from or combined with the "nominee name" statements and, if separately provided, can be delivered 10 days later than the "nominee name" statements. The disclosure requirements for these statements become effective on July 15, 2015.
- *Annual statements of account – investment fund managers.* Investment fund managers must deliver annually an account statement to investors for whom there is no dealer or adviser of record. The enhanced disclosure requirements (which track the requirements for "client name" statements) for these statements become effective on July 15, 2015.
- *Enhanced annual statements for scholarship plan investments (scholarship plan dealers).* The enhanced disclosure requirements for these statements become effective on July 15, 2015 and are specific to scholarship plans (group RESPs).

The various account statements must include:

- "Position cost information" – this can be either integrated into the account statement or provided in a separate document sent within 10 days of the related account statement for each security position in the statement. Based on the comments received, the CSA will now allow firms to choose between "original cost" and "book cost" for this disclosure. Both are defined terms - "original cost" is the total amount paid to purchase a security, including any transaction charges related to the purchase, while "book cost" is the total amount paid for a security, including any transaction charges related to its purchase, adjusted for reinvested distributions, returns of capital and corporate reorganizations.
- "Market value" of each security. "Market value" is defined according to a prescribed hierarchy of valuation methods that depend on available information. Securities for which no market value can be determined must not

be included in the market value calculation for an account, but prescribed disclosure must be provided about this.

- Account statements listing securities in "client name" must include a description of the name of the party that holds or controls each security and how the security is held.
- Identification of which securities are subject to a DSC.

It will be necessary for a dealer to carefully consider the new requirements for quarterly statements about client name securities and determine whether or not these requirements apply to the dealer in respect of securities held by a client. The CSA have articulated when these statements would be required and are clear that they expect dealers to provide these reports. This requirement will be a significant change to industry practices for mutual fund dealers, who place trades for clients that are held in "client name" at the applicable fund managers. While mutual fund dealers may "outsource" this requirement, this will give rise to more complex considerations about outsourcing arrangements and oversight of fund managers by dealers. We expect that this issue will require further discussion by the MFDA and IIROC, as well as their members.

Annual Charges and Compensation Report

In an effort to assist clients in understanding the costs that are associated with their account with a registered firm, as well as the compensation received by the firm in respect of that account, the CRM Amendments require firms (other than investment fund managers) to provide clients with an annual summary of all charges incurred by the client and all other compensation received by the firm that relates to the client's account. The report may be combined with or accompany a client's account statement, or may be provided within 10 days of the delivery of the account statement. A sample form of the report is included in the Companion Policy. These requirements do not apply in respect of accounts for "permitted clients" that are not individuals.

These requirements become effective on July 15, 2016.

The annual report on charges and compensation will be required to include:

- The firm's current "operating charges" that may apply to the account.
- The total amount of each type of operating charge and transaction charge paid by the client during the previous 12 months, along with the total aggregate operating charges and the total aggregate transaction charges.
- In respect of debt securities purchased or sold during the 12 month period, disclosure regarding compensation paid to the firm, or the commission charged by the firm and disclosure stating that compensation paid to the firm may have been added to, or deducted from, the price of the securities and that this amount is in addition to any commission.
- Specific disclosure about the amount of trailing commissions received by the registered firm, in respect of investments held in the client's account. Investment fund managers are required to provide this information to dealers and advisers.
- The total amount of payments (not including trailing commissions) paid to the registered firm by any third party in relation to the client during the past 12 months. The CSA clarify in the Companion Policy that they intend for this provision to capture referral fees, success fees on the completion of a transaction, or finder's fees that are paid by a third party to a registered firm or

any of its registered individuals in relation to a client of the firm. This disclosure needs to be accompanied by an explanation of each type of payment.

Disclosure must be presented on “nominee name” securities separately from “client name” securities.

Annual Performance Reporting

Registered firms will be required to provide clients with an annual account-based investment performance report that can be either part of, or accompany, a quarterly account statement, or be provided within 10 days of the delivery of a quarterly account statement. This requirement will not apply to a dealer in respect of a client’s account in which the dealer executes trades on the instructions of an adviser acting for the client, nor will it apply to accounts for “permitted clients” that are not individuals.

These disclosure requirements will be effective on July 15, 2016.

Extensive guidance is contained in the Companion Policy on how the performance information should be presented. The CSA have not prescribed the specific format of the report but the report must contain text, tables and charts and explanatory notes. A sample form of report is included in the Companion Policy.

The essence of the annual performance report is that clients would be shown the opening market value of an account, plus deposits into the account, less withdrawals from the account (at market value), which would be compared to the closing market value of the account to determine the change in value of their account over the past 12-month period and also since the inception of the account. Investors will then know how much money they have actually made or lost in dollar terms. This information will be enhanced by disclosure of mandated performance numbers (one, three, five and 10 year (or since inception if less than10 years)).

The disclosure in the annual performance report will be required to include:

- The market value of all cash and securities in the account at the beginning and end of the 12-month period covered by the report.
- The market value of all deposits and transfers of cash and securities into the account and the market value of all withdrawals and transfers of cash and securities out of the account, in the 12-month period covered by the report.
- The annual and cumulative change in value of the account, calculated according to specific formulas.
- Annualized total percentage returns calculated using a “money-weighted” rate of return calculation method for specified time periods – one, three, five and 10 year periods and “since inception period” – periods of less than one year cannot be annualized. Special rules will apply to accounts opened before July 15, 2015.
- The definition of “total percentage return” and a notification that the total percentage return in the investment performance report was calculated net of charges, and an explanation of the calculation method.
- For scholarship plans (group RESPs), specific risk and cost disclosure that is unique to these investment vehicles.

Disclosure must be presented on “nominee name” securities separately from “client name” securities.

Significantly, the CSA encourage dealing representatives to meet with clients to help ensure they understand their investment performance reports and how the information relates to the client's investment objectives and risk tolerance.

Permitted Consolidation of Reports

Firms will be permitted to consolidate the various required information in one report that covers more than one account for a client [for instance a registered and non-registered account] if the client has consented to this in writing and if the consolidated report specifies which accounts it consolidates. However, the current common practice of providing families a consolidated statement for all of their accounts held or managed by a registered firm [that is, household accounts] will be permitted, but must be accompanied by the separate reports per client as required under NI 31-103.

The CRM Amendments are complex and represent significant new compliance obligations that will require systems and compliance modifications at most, if not all, registered firms. Representatives will also require training on the new requirements and expectations – given the CSA's expectations that new, more detailed, discussions will take place between advisors and retail clients. Notwithstanding the relatively generous phase-in times for the new requirements, we recommend that firms carefully review these requirements now and begin to determine what changes will be necessary – and how these changes can be effected - to ensure compliance by the applicable deadlines.

Please contact the authors of this Bulletin, your usual lawyer in BLG's Investment Management group or the leaders of BLG's Investment Management group noted below if you have any questions about the CRM Amendments and how they may affect you.

BLG's Investment Management group has the depth of expertise and experience to help you develop a road map for compliance, including developing compliance project plans, reviewing and revising account opening documentation and conducting training and continuing education sessions for advisors, representatives, compliance professionals and executive.

[1] Please see *The Canadian Securities Regulators' Proposals for a "Best Interest" Standard for Dealers and Advisers: the Long Road Ahead"* Investment Management Bulletin April 2013 Borden Ladner Gervais LLP [available here] for a discussion of these initiatives.

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