13.1.11 IIROC Rules Notice – Request for Comments – Client Relationship Model

IIROC RULES NOTICE

REQUEST FOR COMMENTS

CLIENT RELATIONSHIP MODEL

Summary of the nature and purpose of the proposed Rules and amendments

The proposed Rules and amendments have been introduced to establish substantive requirements developed under the Client Relationship Model (CRM) Project for the purpose of addressing the following regulatory objectives:

- Relationship disclosure;
- Management and disclosure of conflicts of interest;
- Account suitability; and
- Account performance reporting.

To a degree, the issues identified above may be viewed discretely. They may also be viewed as key elements of a broader CRM framework and complementary to the fundamental obligation of all dealers and their representatives under National Instrument 31-505 to deal fairly, honestly and in good faith with their clients.

Disclosure of the details of the account relationship and the services to be provided are necessary to better inform the client of the nature of their account relationship. This disclosure, along with account cost and activity reporting will provide clients with important information to use in assessing the performance of investments in their account and whether their objectives and expectations for the account have been satisfied.

A new Rule has been proposed to clarify IIROC's position regarding the management of conflicts of interest. The Rule will require Dealer Members to develop and maintain policies and procedures to identify, disclose and address all real and potential conflicts.

Amendments to the account suitability requirements have been introduced to enhance the level of investor protection for retail clients by ensuring that the suitability of investments in each client's account is assessed whenever:

- a trade is accepted,
- a recommendation is made,
- securities are transferred or deposited into the account,
- there is a change of representative on the account, or
- there is a material change to the know-your-client information for the account.

Response to comments

Proposed rule changes to address the CRM issues were published by the Investment Dealers Association (IDA) in February, 2008 and subsequently adopted by the IIROC Board in May, 2008. IIROC staff's response to the comments received on the proposed amendments has been posted on the IIROC website (IIROC – Policy Proposals).

As noted below, IIROC staff has made several revisions to the proposed CRM Rules and amendments to address comments received. The revised proposed Rules and amendments, as well as a draft guidance note, have been re-published for comment for a period of 90 days with this Notice.

Description of the proposed Rules and rule-making process

Current IIROC rules address some aspects of the core principles under CRM. However, there are significant gaps in other respects, such as the requirement to provide relationship disclosure information on account opening and the requirement to provide account performance reporting. The proposed Rules and amendments are designed to address the gaps that have been identified.

The CRM Project is essentially an extension of the earlier work of the Ontario Securities Commission (OSC) Fair Dealing Model Committee, which released the Fair Dealing Model Concept Paper in January, 2004. This Concept Paper envisioned extensive changes to the regulatory requirements applicable to retail client accounts, from the negotiation and documentation of the relationship at account opening to the transactional information and account reporting to be provided to clients on an ongoing basis.

In September 2004, the Fair Dealing Model initiative was brought under the umbrella of the broader Registration Reform Project (RRP) of the provincial securities commissions. The aim of RRP is to streamline and harmonize the registration regime and develop rules in certain key areas to apply to all registrants on a national basis. Under RRP, the Fair Dealing Model initiative was re-branded as the Client Relationship Model and its focus narrowed to the following three areas:

- account opening documentation;
- costs, conflicts and compensation transparency; and
- performance reporting.

Working groups consisting of industry and regulatory staff developed rulemaking recommendations for each of these areas. A joint rulemaking committee of the IDA and the Mutual Fund Dealers Association (MFDA) then drafted rule proposals in consultation with staff of the securities commissions. This was followed by an initial dealer review of the proposals by three joint IDA/MFDA industry subcommittees. Samples of proposed new disclosures were reviewed and commented on by approximately 370 advisors that participated an 11 city broadcast consultation that was held in August, 2006. These initial drafts were also distributed for comment to the IDA Compliance and Legal Section and the IDA Financial Administrators Section in September 2006. Presentations on the contents of these initial drafts were provided to each of the IDA District Councils in October and November 2006. In response to the comments received on these initial drafts, IDA staff re-drafted its proposals to focus more closely on the core CRM objectives and to factor in potential implementation issues.

As noted above, proposed rule changes to address the CRM issues were published by the IDA in February, 2008 and subsequently adopted by the IIROC Board in May, 2008. IIROC staff has reviewed the comments received in response to the February, 2008 publication. We have also conducted further consultations with industry associations, the MFDA and the provincial securities regulators. The proposed Rules and amendments brought forward for consideration with this Notice incorporate feedback received through the comment process and these subsequent consultations.

The proposed Rules and amendments are summarized as follows:

(a) Relationship disclosure

IIROC is proposing that every dealer will provide its retail clients with the following information regarding the relationship they are entering into with the client:

- a description of the types of products and services offered by the dealer;
- a description of the account relationship to which the client has consented;
- where applicable, a description of the process used by the Dealer Member to assess investment suitability, including a description of the process used to assess the client's "know your client" information, a statement as to when account suitability will be reviewed and an indication whether or not the dealer will review suitability in other situations, including market fluctuations;
- a statement indicating Dealer Member and adviser conflicts of interest and stating that future conflicts of interest situations, where not resolved, will be disclosed to the client as they arise;
- a description of all fees, charges and costs associated with operating the account and in making or holding investments in the account; and
- a description of account reporting the client will receive, including a statement indentifying when account statements and trade confirmations will be sent to the client and a description of the Dealer Member's obligations to provide account performance information and a statement indicating whether or not percentage return information will be sent.

The obligations of Dealer Members to provide certain specific disclosures regarding suitability will vary for order-execution only and managed accounts, in that there is no suitability obligation regarding execution only service and

managed accounts must be monitored and supervised according to the specific standards imposed under Rule 1300 and Rule 2500.

IIROC will not mandate the format of the disclosures, but will require that the information be:

- Provided to the client in writing at the time of account opening;
- Written in plain language; and
- Included in a document entitled "Relationship Disclosure".

Dealer Members are obligated to provide some of the relationship disclosure information under the current Rules. The proposed Rule allows for information already provided to clients to essentially be incorporated by reference as long as the relationship disclosure contains a description of this information and the client is specifically referred to the other documents.

(b) Conflicts management / disclosure

Rules relating to the management of conflicts of interest are already in place. To supplement these existing requirements, IIROC is proposing to adopt a general rule to require that where conflict situations cannot be avoided, all such conflicts must be disclosed and addressed in manner that is consistent with the best interests of the client.

(c) Account suitability

In addition to the current suitability requirement for trades accepted and recommendations made on retail client accounts, IIROC is proposing that an account suitability review must be performed when certain "trigger" events occur (i.e., transfers/deposits into an account, material change in client circumstances, change in the account representative). It is currently an industry best practice to perform suitability assessments on a periodic basis irrespective of the "trigger" events.

IIROC staff is examining the possibility of introducing further changes to the suitability rule, in addition to the amendments noted above. Some of these may include consequential amendments to conform the suitability requirements contained in Rule 1300 to the new relationship disclosure requirements. In particular, the proposed relationship disclosure requirements will require the Dealer Member to advise the client that he or she will be provided with a copy of the "know your client" information collected at account opening and when there are material changes to this information. The proposed amendments may also lead to changes in the supervisory requirements under Rule 2500.

Staff is also in the process of drafting guidance to Dealer Members on regulatory expectations for meeting their suitability requirements.

(d) Account performance reporting

In developing the proposed Rules on performance reporting, issues regarding security position cost disclosure, account activity disclosure and account percentage return disclosure were considered.

(i) Security position cost disclosure

IIROC is proposing to mandate that security position cost information be provided to all retail clients at least annually. When the proposed Rules were published for comment in February, 2008, input was requested as to the preference to require the disclosure of original cost or tax cost. No clear consensus was reached on this point. However, as we believe original cost provides the most useful information for the purpose of account performance, we have mandated in the proposed amendments that original cost be disclosed.

(ii) Account activity disclosure

IIROC is proposing to mandate that account activity information be provided to all retail clients on at least an annual basis. This reporting would require disclosure of the cumulative realized and unrealized capital gains on the client's account.

(iii) Account percentage return disclosure

At this time, IIROC is not proposing to mandate that account percentage return information be provided to retail clients. However, we believe that account percentage return information is important for clients, as it allows for easy comparison of actual account returns to potential returns that might be received from other investments. Therefore, our intent is to continue to study the cost and implementation issues surrounding

percentage return reporting with the objective of requiring that this information be provided to clients as soon as possible. We will continue to work with IIROC Dealer Member firms in order to understand and address any existing impediments to the provision of this information to retail clients.

As noted above, IIROC is proposing to mandate that dealers disclose to clients at account opening whether they will be provided with percentage return information. In addition, where Dealer Members choose to provide percentage return information to retail clients, they will be required to calculate account percentage returns in accordance with a method acceptable to IIROC.

IIROC staff will provide guidance as to acceptable percentage return calculation methods. This will include both dollar-weighted and time-weighted methods.

The proposed Rules and amendments were approved by the IIROC Board of Directors on March 25, 2009. The text of the proposed Rules and amendments is set out in Attachments 1 through 4.

Issues and alternatives considered

In the course of working on the CRM project, IIROC staff has consulted extensively with industry participants and the public. As a result, staff has been presented with a number of different alternatives and perspectives on the issues to be addressed.

Many industry commenters have raised questions regarding value of the proposed changes in light of the potential costs to industry participants. IIROC staff has continued to receive input on the cost issue throughout the rule-making process and is confident that it is aware of, and has properly considered the issue. To minimize potential costs, wherever possible, staff has revised the proposal to provide greater flexibility to Members in complying with the new requirements without compromising the investor protection goals of the CRM project.

In addition, to assist in mitigating the impact of costs, IIROC will provide transition periods to allow Dealer Members sufficient time in the development and implementation of the systems necessary to comply with new requirements. Before setting any timelines, staff will be consulting with Dealer Members to develop a transition plan for the various aspects of the proposal.

Many industry participants have suggested that the regulatory objectives of CRM should be addressed through broad principles-based requirements alone. Staff recognizes that there are advantages with principles-based rules, but the need to communicate baseline minimum standards must also be considered. IIROC staff believes that the proposed Rules and amendments strike an appropriate balance, setting out clear standards while allowing a sufficient degree of flexibility to accommodate differences in Dealer Members' business models.

Consideration was also given to the suggestion that a standard form boilerplate disclosure document be developed to address the relationship disclosure issue. However, while staff acknowledges that some aspects of the relationship disclosure information may be common to all Dealer Members, we also expect that there will be a great deal of variation between firms regarding the specific products and services provided and the processes Dealer Members put in place to deliver those products and services. We believe that the identification of these differences is essential information for clients to make informed choices as to the different options that are available to them. IIROC staff does not believe that the regulatory objectives of relationship disclosure can be satisfied by simply providing a standard form generic disclosure document that lists products and services that a dealer may or may not offer without differentiating between firms.

The need for consistency across the various segments of the securities industry was also raised in many comments received by staff. Some of the inconsistencies in the approach to the CRM issues taken by IIROC, MFDA and the securities commissions may be due to differences in the way business is conducted by the different types of registrants. In any case, staff has reviewed and revised the proposed changes with a view to ensuring, as much as possible, that there is consistency with the proposed requirements to apply to other industry sectors. To this end, the relationship disclosure content requirements have been amended and re-organized.

IIROC staff maintains the position that the relationship disclosure information should function as a foundation document that provides a single reference point for key information on the account relationship. However, in the interests of avoiding duplication of the information, the proposed Rule has been re-drafted to allow for disclosure provided to clients in other materials to be referenced. In such cases, the relationship disclosure must contain a description of the information and the client must be specifically referred to the other documents that have been provided.

On the issue of conflicts of interest, staff has made changes to the proposed Rule to clarify that the Dealer Member must "address" rather that "resolve" conflicts and that the Dealer Member must avoid conflicts only if the conflict cannot be addressed in the client's best interests.

Staff also notes the potential challenges pointed out by industry participants on the issue of performance reporting. To address the comments we received, the proposed rule regarding activity reporting has been simplified so that Dealer Members will be required only to disclose the cumulative realized and unrealized income and capital gains/losses on the customer's account. To provide Dealer Members with greater flexibility, the proposed Rule has also been amended to allow for percentage rates of return, if provided, to be calculated by any method acceptable to IIROC. The requirement to disclose returns, if reported, on a 1, 3, 5 and 10 year basis has been maintained, but as the requirement will apply on a prospective basis, it is not anticipated that it will create a significant compliance burden on Dealer Members.

Many commenters argued that performance reporting is strictly a service issue and that it should be left up to dealers to decide whether they choose to provide any such reporting to clients. However, IIROC's primary mandate is to protect the interests of investors and this responsibility partly involves setting minimum service levels for clients. IIROC's position is that it is reasonable to expect that clients receive cost information and account activity reporting that is sufficient to allow them to determine whether they have gained or lost money on the investments in their accounts.

Again, as noted above, the proposed Rules and amendments will be subject to transition periods to allow for systems changes to be implemented before the amendments become effective. IIROC staff will be consulting with industry participants before setting timelines.

We will also be issuing guidance to clarify staff expectations and answer questions on the application of the proposed Rules and amendments. A preliminary draft guidance note is attached as Attachment 5. We invite Dealer Members and other interested parties to provide their comments on the draft and, in particular, look for feedback on other areas to be addressed.

Comparison with similar provisions

The CRM-related proposals of the MFDA and the Canadian Securities Administrators (CSA) are summarized below.

For the purpose of comparison, we have also noted certain provisions set out in the U.K. and U.S. rules regarding account relationship disclosure and performance reporting. This information has been included to provide some background and context, but is not intended to serve as a comprehensive analysis of international requirements relating to CRM issues.

(a) Mutual Fund Dealers Association of Canada

As noted above, IIROC staff has been exchanging information and holding ongoing meetings with staff of the MFDA and the securities commissions with a view to developing harmonized rules to address the CRM issues.

The revised CRM proposal of the MFDA, is substantially similar to the IIROC proposed Rules and amendments in most respects. All of the core elements of the CRM project are addressed under both proposals, as are the proposed changes to the suitability requirements. Some noteworthy differences between the two proposals are summarized below:

- The MFDA proposal allows for the required disclosure elements to be disseminated in a variety of documents. IIROC's proposed Rule states that where specific information has already been provided to the client by the Dealer Member, the relationship disclosure information can simply include a general description and a reference to the other disclosure materials containing the required information. The revised IIROC requirement is intended to provide greater flexibility for Dealer Members than the previous IDA proposal which required that clients be provided with a single stand alone relationship disclosure document containing all of the mandatory information. The new proposed Rule allows Dealer Members to continue to use their existing processes to deliver specific information, such as fee disclosure, but maintains the requirement that clients be provided with a comprehensive user friendly source for at least basic account relationship information.

- Most of the specific relationship disclosure requirements are contained in both the IIROC and MFDA proposals. There are differences in that the IIROC proposal requires specific disclosure as to whether client accounts will be reviewed at times other that the regulatory minimum (such as in the event of a market disruption) and whether the client will be provided with percentage return information. The MFDA proposal does not require such disclosure. IIROC's position stems from the concern that clients may presume that their accounts are being reviewed by their representatives whenever significant market events occur and that they are entitled to receive percentage return information on statements. If these services are not to be provided, Dealer Members should advise clients accordingly, so that client expectations are properly managed.

- The MFDA performance reporting proposal does not require individual position cost disclosure, which is required under the IIROC proposal.

- The activity reporting requirements in the IIROC and MFDA proposals are similar in most respects. However, the MFDA proposes to mandate account activity disclosure for the current year only, while the IIROC proposal will require cumulative activity reporting.

- Neither of the IIROC or MFDA amendments propose to mandate percentage return performance reporting. The IIROC proposed Rules and amendments specify that percentage return information, if provided, must set out returns for 1, 3, 5 and 10 year periods. This is not required in the proposed MFDA rule.

Details of the proposed amended MFDA rules and policies can be accessed at www.mfda.ca.

(b) Canadian Securities Administrators

IIROC staff has also participated in the development of National Instrument 31-103, which also addresses elements of the CRM project and in particular, relationship disclosure and conflicts management. NI 31-103 is intended, in part, to impose requirements similar in effect to the CRM proposals of the SROs on registrants that are not subject to SRO jurisdiction.

Following our previous publication of the proposed Rules, several commenters pointed out that there are significant differences between the IIROC proposal and the relationship disclosure requirements under proposed National Instrument 31-103. Staff has been advised that conforming amendments to NI 31-103 on these issues will be introduced at a later date, once the IIROC and MFDA requirements have been finalized.

The current NI 31-103 proposal may be accessed on the Ontario Securities Commission website at http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/rule_20080229_31-103_rfc-reg-req.pdf.

CSA Statement

The CSA is now finalizing the requirements in NI 31-103 and reminds the SROs and their members that once it is in effect all registrants will be required to comply with the principle for relationship disclosure in that instrument. The principle in the CSA's most current version of NI 31-103 is that all registrants must provide their clients with information a reasonable client would consider important on account opening. The CSA has confirmed to the SROs that their CRM requirements must remain consistent with that finalized principle in NI 31-103.

The CSA is also developing a principle for performance reporting for the first round of amendments to NI 31-103. The CSA will expect the SROs to ensure that their requirements for performance reporting are consistent with that principle.

(c) United Kingdom

The U.K. Financial Services Authority ("FSA") also has implemented principles-based rules that address some of the issues raised under CRM.

The FSA Conduct of Business sourcebook (COBS) sets account relationship related disclosure requirements as follows:

- COBS 2.2 – A firm must provide appropriate information in a comprehensible form to a client about the firm and the types of products (including specific types of investments and investment strategies) and services offered by the dealer and the costs and associated charges relating to these products and services before these products and services are provided. This disclosure may be provided in a standardized format.

- COBS 6.1 – Unless subject to COBS 9.6.5, a firm must provide retail clients the following information (along with other additional information) if relevant:

  (1) the name and address and contact details of the firm;

  (2) a statement that the firm is authorized and the name of the authorizing body (and the contact information for the authorizing body);

  (3) the nature, frequency and timing of reporting to be provided to the client;

  (4) disclosure regarding conflicts of interest;

  (5) disclosure regarding investments or cash held by the firm for a retail client;

(6) information on costs and account charges;

(7) information on the investor compensation scheme to which the firm belongs.

- COBS 8.1 – Requirement to enter into a written basic agreement with a retail client setting out the rights and obligations of both parties.

- COBS 9.6.5 – A firm that offers "basic advice" on "stakeholder products" must provide clients with the following information:

(1) the name and address of the firm;

(2) a statement as to whether investment products being offered come from one company, a limited number of companies or the capital markets as a whole;

(3) a statement that the service being offered is basic on a limited range of investment products;

(4) a statement that the firm is regulated by the FSA;

(5) a statement disclosing any product provider loans;

(6) a description of the complaint handling process and the circumstances under which a client can refer a matter to the Financial Ombudsman Service;

(7) a description of the circumstances and the extent to the client will be entitled to compensation from the Financial Services Compensation Scheme.

On the issue of performance reporting, the FSA Handbook contains the following requirements:

- COBS 16.3 – Where a retail client has a managed account with a firm, a periodic statement must be provided every six months at a minimum (every three months if the client requests) which must include the following information (as referenced in the Conduct of Business Sourcebook Rule 16 Annex 2R):

(1) market value of each position held;

(2) cash balance at the beginning and end of each reporting period;

(3) the performance of the portfolio during the reporting period;

(4) the fees and charges incurred during the reporting period;

(5) a comparison of the performance during the reporting period to a performance benchmark (if agreed to between the firm and the client);

(6) details of the total amount of dividends, interest and other payments received during the reporting period and details of other relevant corporate actions.

The Conduct of Business Sourcebook can be accessed at FSA Handbook.

The FSA is continuing to look at ways to improve the interaction between consumers and industry participants and is in the process of conducting a Retail Distribution Review aimed at:

- improving the clarity for consumers of the characteristics of different service types and the distinctions between them;

- raising professional standards; and

- reducing the conflicts of interest inherent in remuneration practices and improving transparency of the cost of all advisory services.

The FSA advises that their intent is to publish a consultation paper outlining policy proposals to address to these issues in June 2009.

Information relating to the FSA's Retail Distribution Review can be accessed at www.fsa.gov.uk.

(d) United States

Under the *Investment Advisers Act of 1940*, a registered adviser that gives personal advice generally is required to supply each prospective advisory client with a copy of part of its registration application (Part II of Form ADV) or a written document, such as a brochure, containing the information required by the form. Additionally, the brochure is to be offered to current clients annually. Part II of Form ADV includes the following:

- the approximate percentage of billings from each type of advisory service itemized in the form;
- the types of compensation arrangements used by the adviser, the fee schedule, and how to obtain a refund or end an advisory contract before its expiration;
- the types of clients of the adviser;
- the categories of investments about which the adviser offers advice;
- methods of security analysis, sources of information, and investment strategies;
- the education and business backgrounds of particular individuals;
- other business activities of the adviser;
- other financial industry activities or affiliations (including registration) of the adviser and related persons;
- participation or interest in client transactions;
- information on the frequency, level, and triggering factors for account reviews and the nature and frequency of reports to clients on their accounts.

On the issue of account opening documentation, the Financial Industry Regulatory Authority (FINRA) has also provided some guidance to their members in the form of a new account application template. There is no regulatory requirement to use the sample form, or any portion of it. Rather, the intent of the form is to provide basic plain language examples of what a firm might use to describe client risk profile and issues the client should be aware of when evaluating account performance information. The form may be accessed at FINRA - Information Notice - 10/21/08.

Effects of proposed Rule on market structure, Dealer Members, non-members, competition and costs of compliance

The effect of the proposed Rules and amendments will be to improve the quality of information that clients are provided regarding their account relationships and with the performance of investments in their accounts. Clients will also be better served through more frequent monitoring of their accounts and better conflict management procedures at Dealer Members.

In developing the proposed Rules and amendments, the possibility of performing costs versus benefits analysis work was examined in some detail. An independent research company was hired to provide recommendations and assist in completing this work. Meetings involving staff from the IDA, MFDA, OSC, the Investment Funds Institute of Canada, the Investment Industry Association of Canada and representatives from investment dealers and mutual fund dealers were held to discuss the approach to be taken on the cost/benefit analysis. However, no agreement on the approach was reached. While the proposed formal cost/benefit analysis was not performed, substantial feedback from industry participants was provided throughout the rule development process in any case. As such, IIROC staff believes that it is sufficiently informed as to the potential impacts of the proposed Rules and amendments.

It is expected that the systems and cost impacts will be the greatest for the relationship disclosure and performance reporting proposals. The extent of the impact for relationship disclosure will be influenced by:

1. *Relationship disclosure customization* – Dealer Members that choose to customize the relationship disclosure to address individual client account details will likely have greater initial and ongoing compliance costs. Greater customization will also lead to more frequent revisions to the relationship disclosure to ensure it properly reflects the specific client situation.

2. *Relationship disclosure implementation period for existing accounts* – A longer relationship disclosure implementation period for existing accounts will lessen the costs of initial compliance.

The extent of the systems and cost impact for the performance reporting requirements will be influenced by:

1. *Report data requirements* – Dealer Members will be required to warehouse greater amounts of historical information to produce the reports.

2. *Report calculation requirements* – Costs will likely increase where a greater number of calculations must be performed to generate the report.

The costs incurred may also differ between Dealer Members as many firms already furnish at least a portion of the information required under the new minimum standards. The effect on a particular Dealer Member can only be precisely determined by performing a firm specific assessment, but may include costs associated with the production of documents (including printing and mailing) and the imposition of new compliance and supervisory requirements.

As previously noted, an appropriately long transition period will be provided to allow Dealer Members time to make necessary systems changes. IIROC will continue to consult with Dealer Members in developing an implementation schedule.

Apart from the issues described above, it is not expected that there will be other major technological systems impacts on Dealer Members as a result of the proposed Rules and amendments. Further, it is not anticipated that there will be other significant effects on Dealer Members or non-Dealer Members, market structure or competition.

It is believed that the benefits associated with the proposed requirements are significantly greater than the additional costs to Dealer Members. The proposed Rules and amendments do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in the furtherance of IIROC's regulatory objectives. The proposed Rules and amendments do not impose costs or restrictions on the activities of market participants that are disproportionate to the goals of the regulatory objectives sought to be realized.

The IIROC Board has determined that the proposed Rules and amendments are not contrary to the public interest.

Anticipated effective date and implementation plan

IIROC anticipates that the proposed Rules and amendments will be made effective on a date to be determined by IIROC staff after receiving notification of approval by the requisite provincial securities commissions.

As noted above, transition periods for some of the requirements under the proposed Rules and amendments will also apply.

Classification of Rules and amendments and filing in other jurisdictions

IIROC has determined that the proposed Rules and amendments are Public Comment Rules and has directed that the proposed Rules and amendments be published for comment.

The proposed Rules and amendments will be filed with each of IIROC's Recognizing Regulators, in accordance with s.3 of the Joint Rule Review Protocol contained in the IIROC Recognition Order.

Request for public comment

Comments should be made in writing. One copy of each comment letter should be delivered within 90 days of the publication of this notice, addressed to the attention of:

Mark Stechishin
Policy Counsel
Investment Industry Regulatory Organization of Canada
Suite 1600, 121 King Street West
Toronto, Ontario
M5H 3T9

A second copy should be addressed to the attention of:

Manager of Market Regulation
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8
marketregulation@osc.gov.on.ca

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca under the heading "IIROC Rulebook - Dealer Member Rules - Policy Proposals and Comment Letters Received").

Attachments

Attachment 1 – Proposed Amendments – New Rule XX00 – Relationship disclosure;

Attachment 2 – Proposed Amendments – New Rule XX00 – Conflicts of interest;

Attachment 3 – Proposed Amendments – Black-line copy of amended Rule 1300.1 – Supervision of accounts;

Attachment 4 – Proposed Amendments – Amended Rule 200.1 – Minimum Records;

Attachment 5 – Draft Guidance Note.

ATTACHMENT 1

PROPOSED AMENDMENTS TO THE IIROC DEALER MEMBER RULES – PROVISIONS RESPECTING IMPLEMENTATION OF THE CLIENT RELATIONSHIP MODEL

PROPOSED AMENDMENTS – NEW RULE XX00 – RELATIONSHIP DISCLOSURE

1. New Rule XX00 is enacted as follows:

XX01. Objective of relationship disclosure requirements

(1) This Rule establishes the minimum industry standards for relationship disclosure to retail clients at the time of opening an account or accounts. This Rule does not apply to accounts of institutional clients.

Relationship disclosure is a written communication from the Dealer Member to the client describing:

- the products and services offered by the Dealer Member;
- the nature of the account and the manner in which the account will operate; and
- the responsibilities of the Dealer Member to the client.

References in this Rule describing the obligations of the Dealer Member in relation to services provided on advisory and managed accounts apply equally to the Approved Persons of the Dealer Member providing services on such accounts.

This Rule should be reviewed in conjunction with:

- Rules 1300.1 and 1300.2 – Know your client, suitability and supervision;
- Rules 1300.3 to 1300.21 – Discretionary and managed accounts;
- Rule 2500 – Minimum standards for retail account supervision; and
- Rule 3200 – Minimum requirements for Dealer Members seeking approval under Rule 1300.1(s) for suitability relief for trades not recommended by the Member.

XX02. Definition of account relationship types

(1) An "advisory account" is an account where the client is responsible for investment decisions but is able to rely on advice given by a registered representative. The registered representative is responsible for the advice given. In providing this advice, the registered representative must meet an appropriate standard of care, provide suitable investment recommendations and provide unbiased investment advice.

(2) An "order-execution service account" is an account opened in accordance with "order-execution service" requirements set out in Rule 3200.

(3) A "managed account" is an account as defined in Rule 1300.3.

XX03. Form of relationship disclosure

(1) Dealer Members have the choice of providing customized relationship disclosure to each client, or appropriate standardized relationship disclosure to separate classes of clients.

(2) Where standardized relationship disclosure is provided to the client the Dealer Member must determine that the disclosure is appropriate for the client. Specifically, the disclosure must accurately describe:

(a) the account relationship the client has entered into with the Dealer Member; and

(b) the advisory, suitability and performance reporting service levels the client will receive from with the Dealer Member.

(3) Where a client has more than one account, combined relationship disclosure information may be provided as long as the Dealer Member determines that the combined disclosure is appropriate for the client in light of the relevant circumstances, including the nature of the various accounts.

XX04. Format of relationship disclosure

(1) The format of the relationship disclosure is not prescribed but:

(a) The relationship disclosure must be provided to the client in writing;

(b) The relationship disclosure must be written in plain language that communicates the information to the client in a meaningful way; and

(c) The relationship disclosure must include all the required content set out in Section XX05, or, where specific information has otherwise been provided to the client by the Dealer Member, a general description and a reference to the other disclosure materials containing the required information.

(2) Dealer Members may choose to provide the relationship disclosure as a separate document or to integrate it with other account opening materials.

XX05. Content of relationship disclosure

(1) The relationship disclosure information must be entitled “Relationship Disclosure”.

(2) Subject to subparagraphs (3) and (4), the relationship disclosure must contain the following information:

(a) A description of the types of products and services offered by the Dealer Member;

(b) A description of the account relationship;

(c) A description of the process used by the Dealer Member to assess investment suitability, including:

(i) a description of the approach used by the Dealer Member to assess the client’s financial situation, investment objectives, risk tolerance and investment knowledge and a statement that the client will be provided with a copy of the “know your client” information that is obtained from the client and documented at time of account opening and when there are material changes to the information;

(ii) a statement indicating that the Dealer Member will assess the suitability of investments in the client’s account whenever:

(A) a trade is accepted,

(B) a recommendation is made,

(C) securities are transferred or deposited into the account,

(D) there is a change in the registered representative, investment representative or portfolio manager responsible for the account, or

(E) there is a material change to the client’s know-your-client information; and

(iii) a statement indicating whether or not the suitability of the investments held in the account will be reviewed in the case of other triggering events not described in Rule 1300.1(r) and, in particular, in the event of significant market fluctuations;

(d) A description of the client account reporting that the Dealer Member will provide, including:

(i) a statement indicating when trade confirmations and account statements will be sent to the client;

(ii) a description of the Dealer Member's minimum obligations to provide performance information to the client and a statement indicating when account position cost and account activity information will be provided to the client; and

(iii) a statement indicating whether or not the provision of account percentage return information will be an option available to the client as part of the account service offering;

(e) A statement indicating Dealer Member and Approved Person conflicts of interest and stating that future conflicts of interest situations, where not avoided, will be disclosed to the client as they arise;

(f) A description of all account service fees and charges the client will or may incur relating to the general operation of the account;

(g) A description of all costs the client will or may incur in making and holding investments by type of investment product;

(h) A listing of the account documents required to be provided to the client with respect to the account; and

(i) A description of the Dealer Member's complaint handling procedures and a statement that the client will be provided with a copy of an IIROC approved complaint handling process brochure at time of account opening.

(3) For order-execution service accounts, the Dealer Member does not have to provide the relationship disclosure information required under subparagraph 2(c), provided that disclosure is made in compliance with the requirements in Rule 3200.

(4) For managed accounts, the required disclosure referred to in subparagraph 2(c)(iii) does not apply and the relationship disclosure provided by the Dealer Member must include a statement that ongoing suitability is provided as part of the managed account services.

XX06. Review of relationship disclosure materials

(1) Pursuant to Rule 1300.2, the relationship disclosure provided to the client must be approved by a partner, director, officer or designated supervisor. This approval must occur regardless of the form the relationship disclosure takes. If the document is a standardized document, the document must be approved by head office and the supervisor who approves new accounts must ensure that the correct document is used in each client circumstance. If the relationship disclosure is a customized document for each client, the designated supervisor must approve each document.

XX07. Client acknowledgement of receipt of relationship disclosure

(1) The Dealer Member must maintain an audit trail to evidence that the information has been provided to the client. A client signature acknowledging receipt is preferred, but not required. If no signature is obtained, some other method of documenting the provision of the information to the client must be used.

ATTACHMENT 2

PROPOSED AMENDMENTS TO THE IIROC DEALER MEMBER RULES – PROVISIONS RESPECTING IMPLEMENTATION OF THE CLIENT RELATIONSHIP MODEL

PROPOSED AMENDMENTS – NEW RULE XX00 – CONFLICTS OF INTEREST

1. New Rule XX00 is enacted, as follows:

"XX01. Responsibility to identify conflict of interest situations

(1) Each Dealer Member and, where applicable, Approved Person shall use reasonable efforts to identify potential conflicts of interest between the interests of the Dealer Member or Approved Person and the interests of the client.

(2) Where an Approved Person becomes aware of an existing or potential conflict of interest, the existing or potential conflict shall be reported immediately to the Dealer Member.

XX02. Avoidance of conflicts of interest

(1) The Dealer Member must consider the possible implications of any existing or potential conflict of interest and any conflict of interest that cannot be addressed in a manner that is consistent with the best interests of the client must be avoided.

XX03. Addressing conflicts of interest

(1) The Dealer Member and, where applicable, the Approved Person must address the existing or potential conflict of interest:

(a) in a fair, equitable and transparent manner, and

(b) by exercising responsible judgment influenced only by the best interest of the client or clients.

XX04. Conflicts of interest disclosure

(1) Unless a conflict of interest has been avoided, the conflict of interest must be disclosed to the client in all cases where there is a reasonable likelihood that a client would consider the conflict of interest important:

(a) for new clients, prior to opening an account for the client; and

(b) for existing clients, either as they occur or, in the case of transaction related conflicts of interest, prior to entering into the transaction with the client.

XX05. Conflicts of interest policies and procedures

(1) Each Dealer Member shall develop and maintain written policies and procedures to be followed in identifying, avoiding, disclosing and addressing conflict of interest situations."

ATTACHMENT 3

**PROPOSED AMENDMENTS TO THE IIROC DEALER MEMBER RULES –
PROVISIONS RESPECTING IMPLEMENTATION OF THE CLIENT RELATIONSHIP MODEL**

BLACK-LINE COPY OF AMENDED RULE 1300 – SUPERVISION OF ACCOUNTS

1. Rule 1300.1 is amended as follows:

1300.1

"Suitability ~~Generally~~determination required when accepting order

(p) Subject to Rules 1300.1(t~~r~~) and 1300.1(u~~s~~), each Dealer Member shall use due diligence to ensure that the acceptance of any order from a customer is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives, ~~and~~ risk tolerance and any investments in the customer's account.

Suitability ~~d~~Determination ~~r~~Required ~~w~~When ~~r~~Recommendation ~~p~~Provided

(q) Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives, ~~and~~ risk tolerance and any investments in the customer's account.

Suitability determination required for account positions held when certain events occur

(r) Each Dealer Member shall, subject to Rules 1300.1(t) and 1300.1(u), use due diligence to ensure that the positions held in a customer's account or accounts are suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance whenever one or more of the following trigger events occurs:

(i) Securities are received into the customer's account by way of deposit or transfer; or

(ii) There is a change in the registered representative, investment representative or portfolio manager responsible for the account; or

(iii) There has been a material change to the customer's life circumstances or objectives that has resulted in revisions to the customer's "know your client" information as maintained by the Dealer Member.

Suitability of investments in customer accounts

(s) To comply with the requirements under Rules 1300.1(p), 1300.1(q) and 1300.1(r), the Member must use due diligence to ensure that:

(i) The suitability of all positions in the customer's account is reviewed whenever a suitability determination is required; and

(ii) The customer receives appropriate advice in response to the suitability review that has been conducted.

Suitability ~~d~~Determination ~~n~~Not ~~r~~Required

(t~~r~~) Each Dealer Member that has applied for and received approval from the Corporation pursuant to Rule 1300.1(v), is not required to comply with Rule 1300.1(p), when accepting orders from a customer where no recommendation is provided, to make a determination that the order is suitable for such customer.

(u~~s~~) Each Dealer Member that executes a trade on the instructions of another Dealer Member, portfolio manager, investment counsel, limited market dealer, bank, trust company or insurer, pursuant to Section I.B (3) of Rule 2700 is not required to comply with Rule 1300.1 (p).

Corporation aApproval

(vt) The Corporation, in its discretion, shall only grant such approval where the Corporation is satisfied that the Dealer Member will comply with the policies and procedures outlined in Rule 3200. The application for approval shall be accompanied by a copy of the policies and procedures of the Dealer Member. Following such approval, any material changes in the policies and procedures of the Dealer Member shall promptly be submitted to the Corporation."

2. References in Rule 1300.1 and Rule 3200 to Rules 1300.1(p) and 1300.1(t) are amended as follows:

(a) References to existing Rule 1300.1(p) are repealed and replaced by references to new Rules 1300.1(p) and 1300.1(r); and

(b) References to existing Rule 1300.1(t) are repealed and replaced by references to new Rule 1300.1(v).

ATTACHMENT 4

PROPOSED AMENDMENTS TO THE IIROC DEALER MEMBER RULES – PROVISIONS RESPECTING IMPLEMENTATION OF THE CLIENT RELATIONSHIP MODEL

PROPOSED AMENDMENTS – AMENDED RULE 200.1 – MINIMUM RECORDS

1. Rule 200.1 is amended by renumbering existing sections 200.1(d) through (n) as Rules 200.1(g) through (q).

2. Rule 200.1 is amended by adding new Rules 200.1(d), 2001.1(e) and 200.1(f) as follows:

"(d) Customer account cost reports for all accounts other than those held by institutional customers, itemizing security position cost information as follows:

(1) For all new security positions added to the account on or after the latest of:

(i) [Date of implementation],

(ii) The date the account was opened or

(iii) If applicable, the date the account was received in by the Dealer Member firm as a transferred account,

the original cost of the position.

(2) For all existing security positions in the account as of [Date of implementation], the original cost of the position.

Where original cost information is unavailable, Dealer Member firms may elect to provide market value information as at [Date of implementation], or as at an earlier date (referred to as "point in time market value") instead of original cost information, provided that it is done for all accounts and as at the same date.

Where the account was received in by the Dealer Member firm as a transferred account, the market value of the positions as at the date the account was received in via transfer (also referred to as "point in time market value") may be used instead of original cost.

For each security position, the current market value as at the report date shall be provided as a comparison to the cost information. The basis for costing each position (either original cost or point in time market value) must be disclosed.

Customer account cost reports shall be sent to customers annually, at a minimum.

(e) For all accounts other than those held by institutional customers, customer account performance information disclosing the annual and cumulative realized and unrealized income and capital gains in the customer's account. This account performance information shall be sent to customers annually, at a minimum."

(f) If provided by the Dealer Member, customer account performance reports itemizing account annualized compound percentage returns for the customer's account.

Account annualized compound percentage return information

Where account annualized compound percentage return information is provided to the client, it shall be provided indicating the account's performance for the past ten, five, three and one year periods. Where the account has existed for more than one and less than ten years, the account's annualized compound percentage return since inception shall be provided. Where the account has existed for less than one year, account annualized compound percentage return information shall not be provided. The computational method used in determining annualized compound percentage return information shall be a method acceptable to the Corporation.

If provided by the Dealer Member, the report containing account annualized compound percentage return information shall be sent to customers annually, at a minimum."

3. The Guide to Interpretation of Rule 200.1 is amended by renumbering Guide items (d) through (n) as guide items (g) through (q).

4. The Guide to Interpretation of Rule 200.1 is amended by adding new guide items (d) through (f) as follows:

"(d) "**Customer account cost reports"**

Reports must include all customer account security positions held by the Dealer Member firm for the customer in nominee name or physically in client name and all customer account security positions for which the Dealer Member firm continues to receive compensation, subject to the exceptions below.

Where, pursuant to Rule 200.1(d)(2), the original cost information is unavailable and the point in time market value amount is not readily determinable for an individual security position held, cost information for the security position shall not be reported.

Where, a particular long security position held has been determined to be not readily marketable, current market value information for the security position shall not be reported. In such instance, a disclosure in the customer account cost report shall inform the customer that the information has not been reported and why the information has not been reported.

The information provided in the customer account cost report may be provided to the customer on either a dollar amount or dollar amount per share basis.

The customer account cost report may be provided to the customer as part of the customer account statement, referred to in Rule 100.2(c), or separately.

(e) "**Cumulative account performance information"**

The cumulative account performance information must be determined based on all customer account security positions held by the Dealer Member firm for the customer in nominee name or physically in client name and all customer account security positions for which the Dealer Member firm continues to receive compensation, subject to the exceptions below.

Where one or more security positions held in the client account have been determined to be not readily marketable, the security position(s) shall not be considered in the determination of cumulative account performance. In such instance, a disclosure in the cumulative account performance information shall inform the customer of the positions that have been excluded and why the positions have been excluded.

At the option of the Dealer Member firm, customers may be provided with portfolio level (portfolio level being a consolidation of all account security positions and debit/credit money balances of the same customer) cumulative account performance information.

At the option of the Dealer Member firm, customers may instead be provided with cumulative account performance information that delineates advised/non-advised account security positions.

The cumulative account performance information may be provided to the customer as part of the customer account statement, referred to in Rule 100.2(c), or separately.

(f) "**Account annualized compound percentage return information"**

Where account annualized compound percentage return information is provided to the client, it must be determined based on all customer account security positions held by the Dealer Member firm for the customer in nominee name or physically in client name and all customer account security positions for which the Dealer Member firm continues to receive compensation, subject to the exceptions below.

Where one or more security positions held in the client account have been determined to be not readily marketable, the security position(s) shall not be considered in the determination of annualized compound percentage returns. In such instance, a disclosure in the annualized compound percentage return information shall inform the customer of the positions that have been excluded and why the positions have been excluded.

At the option of the Dealer Member firm, customers may be provided with portfolio level (portfolio level being a consolidation of all account security positions and debit/credit money balances of the same customer) annualized compound percentage return information.

At the option of the Dealer Member firm, customers may instead be provided with annualized compound percentage return information that delineates advised/non-advised account security positions.

Account annualized compound percentage return information may be provided to the customer as part of the customer account statement, referred to in Rule 100.2(c), or separately."

ATTACHMENT 5

IIROC RULES NOTICE – DRAFT GUIDANCE NOTE

CLIENT RELEATIONSHIP MODEL

Introduction

This Notice provides guidance for Dealer Members on compliance with the new requirements introduced under the Client Relationship Model (CRM) project. The new Rules and amendments under CRM project address:

- Relationship disclosure;
- Management and disclosure of conflicts of interest;
- Account suitability; and
- Account performance reporting.

While each of these issues can be viewed in isolation, the intent of the CRM project is that the different elements work together within the larger CRM framework and the existing Rules. Essentially, each of the requirements is a part of the broader fundamental obligation of the Dealer Member and its representatives under National Instrument 31-505 to deal fairly, honestly and in good faith with clients.

Wherever possible, the new CRM requirements have been created with the intent of allowing Dealer Members to leverage off of existing processes. However, certain aspects will require Dealer Members to develop new systems, which may pose some significant operational challenges. Therefore, with the input of Dealer Members and other industry participants, IIROC staff has developed a transition plan for implementation of the CRM Rules and amendments. Details of the transition periods that have been approved by the IIROC Board are attached as Schedule 1 to this Notice. **[NTD: to be determined following consultation]**

Relationship disclosure

Rule XX00 establishes minimum standards for client/firm relationship disclosure to be provided by Dealer Members to clients at the time of account opening. The policy rationale underlying the Rule is that all clients should have a good understanding of what they sign up for when they open an account.

The relationship disclosure must include a description of the products and services of the Dealer Member, the nature of the account and the responsibilities of the Dealer Member. Staff expects that many Dealer Members will currently be providing marketing information that includes at least some information on products and services offered. However, to provide a more complete and balanced picture, the client should also be advised as to specific limitations and Dealer Member responsibilities that might exist for different classes of accounts (for example, an order execution account versus an advisory account). The relationship disclosure information will help the clients understand:

- why the information they provide to the Dealer Member is important;
- what service levels to expect from the Dealer Member once the account has been opened; and
- what information the Dealer Member will provide to update the client on the status of the account.

Although there are a variety of business models employed by Dealer Members, IIROC staff expect that in a typical face to face client meeting, the registered representative will sit down with the client and take him or her through the account opening documentation. The representative will collect the necessary know-your-client information, complete the account opening forms and obtain the required client signatures. The client should then be provided with a copy of the forms and disclosure documents. Ideally, throughout this process, the client will be raising any questions and the representative will be providing meaningful responses. However many clients may not be fully engaged in the discussion or may feel intimidated by the process. As a result, they may walk away from the meeting without getting relevant information. The intent of the relationship disclosure is to ensure that all clients have answers to some basic questions on the account relationship, whether or not the client raises these issues with their representative.

The Rule provides for a degree of flexibility as to the form and format of the relationship disclosure, but in all cases the information must be in writing, in plain language and must contain all of the required elements set out in Section XX05. The

Rule allows for standardized disclosure to be provided to particular groups of clients, or all clients. Where the Rule requires the Dealer Member to advise as to whether optional services can be obtained from the Dealer Member, the costs associated with such services should be provided. **[NTD: would Dealer Members like to see a sample relationship disclosure template provided along with the guidance note?]**

The disclosure required under subparagraphs (e), (f), (h) and (i) of Section XX05 reflects existing requirements under other Rules. Going forward, Dealer Members may include this information with the other required relationship disclosure information in a single package. Alternatively, the Rule allows Dealer Members to rely on their existing procedures to deliver this information. In such cases, the relationship disclosure provided by the Dealer Member must include a general description of the information and a reference to the other disclosure materials containing the required information.

As noted in the introduction to this Notice, the relationship disclosure requirements should be viewed in the context of other business conduct rules. One of the fundamentals in the advisory relationship is the requirement for the Dealer Member to satisfy the investment suitability requirements contained in Rule 1300.1. Accordingly, staff expects the Dealer Member to provide a fulsome, clear and meaningful explanation of its suitability obligation in the relationship disclosure information. Further, the client should be made aware of the limitations on the obligation and whether account suitability reviews will be performed in situations apart from those listed in the Rule. In particular, the Rule requires that clients be informed whether any action will be taken by the Dealer Member in response to significant market fluctuations.

The obligations of Dealer Members to provide certain specific disclosures regarding suitability will vary for order-execution only and managed accounts, in that there is no suitability obligation regarding execution only service and managed accounts must be monitored and supervised according to the specific standards imposed under Rule 1300 and Rule 2500. Apart from these limited exceptions for order-execution and managed accounts, all of the required elements listed in Rule XX00 must be addressed in the Dealer Member's relationship disclosure.

Beyond the required content set out in Rule XX00, the Dealer Member may also elect to include additional information in the relationship disclosure. In consulting with Dealer Members in the rule development process, staff has noted that some Dealer Members currently recommend steps to be taken by their clients to maintain a successful relationship with the firm. These include:

- Carefully and promptly reviewing all documentation provided by the Dealer Member that relates to the operation of the account, account investment recommendations, account investment transactions and account investment holdings. This would include the "know your client" information maintained by the Dealer Member for the account; conflicts of interest disclosures; descriptions of all transaction costs and account service fees and charges relating to the account; trade confirmations; and account statements.

- Promptly informing the Dealer Member of changes to the client's life circumstances or objectives that may materially affect the accuracy of the "know your client" information maintained by the Dealer Member for the account.

- Promptly informing the Dealer Member of any trade confirmation or account statement errors.

- Proactively asking questions and requesting information about the account.

- Contacting the Dealer Member immediately if the client is unsatisfied with the handling of the affairs in the account.

Dealer Members are required to provide the relationship disclosure information to all clients. It is expected that new clients will be provided with the information at the time of account opening. Staff acknowledges that there are significant logistical concerns involved in distributing the information to existing clients and is therefore allowing a transition period of three years to provide the information to existing clients. This is in line with current expectations regarding the updating and re-papering of client accounts.

Where significant changes to the relationship disclosure information have occurred, it is expected that the Dealer Member will provide timely notice to clients of any changes. This could be accomplished by including details of the updated information with a regular client communication, such as the client statements.

As noted in section XX07, Dealer Members are required to maintain an audit trail to evidence that the relationship disclosure information has been provided to clients. As a best practice this would be accomplished through a signed client acknowledgement. Alternatively, Dealer Members may rely on other methods, such as negative confirmation, provided that compliance with the basic requirement can be demonstrated by the Dealer Member.

Dealer Members may also satisfy the delivery requirements regarding initial disclosure and subsequent updates through electronic means. Dealer Members that intend to rely on electronic delivery of the information would be expected to satisfy the requirements noted in IDA Member Regulation Notice MR-008.

Conflicts of Interest

There are a number of provisions in the IIROC Rules that relate to specific conflict of interest situations. New Rule XX00 has been implemented to clarify the Dealer Member's general obligations wherever a conflict situation is encountered. The new Rule generally requires Dealer Members to have written policies and procedures in place for identifying, avoiding, disclosing and addressing conflicts. Where a conflict between the interests of the client and those of the Dealer Member is not avoided, the conflict must be disclosed and addressed in manner that is consistent with the best interests of the client.

As with the other elements of the CRM project, the Rule should be read in light of the basic business conduct requirements to deal with clients fairly, honestly and in good faith. The intent is to provide clarity for Dealer Members in how these basic principles can be satisfied when considering conflicts. The Rule should not be interpreted as requiring Dealer Members to identify and eliminate every conceivable conflict, or preventing Dealer Members from profiting from their regular business activities.

The Rule has been drafted to point out the factors that Dealer Members must consider in addressing conflicts. The Dealer Member must use reasonable efforts to identify any real or potential conflicts that may arise in the conduct of business. If a conflict cannot be addressed in a manner that is consistent with the best interests of the client, it must be avoided. If the Dealer Member determines that a conflict does not require prohibition, the Dealer Member must ensure that the conflict is addressed in accordance with Rule XX03. Any material conflict that has not been avoided must be disclosed.

Disclosure is fundamental in responding to a material conflict of interest. The disclosure should be timely and meaningful to the client. Section XX04(1) requires Dealer Members to provide disclosure in any case where there is a reasonable likelihood that a client would consider the conflict of interest important. Disclosure should be made before the product or service related to the conflict is sold or provided to the client. Further, the disclosure should be sufficient to provide the client an understanding of the specific conflict. A generic form of disclosure simply stating that conflicts may arise will not satisfy the Dealer Member's obligation to respond to conflicts properly.

In some cases, disclosure of a conflict combined with informed consent (which may be express or implied, depending on the circumstance) may be sufficient to discharge the Dealer Member's obligation to properly address the conflict. The fact that the Dealer Member and its representatives earn commissions from recommended trades is a conflict that arises every day in the regular course of business. However, as clients generally expect that there is a cost associated with operating an account, the conflict can be adequately addressed simply through disclosure of the amount of fees and commissions that are being charged.

In other cases, to properly address a conflict, the Dealer Member may need to implement policies and procedures in addition to disclosure. Proposed National Instrument 31-103 will require registrants to execute a written agreement as well as providing prescribed disclosure prior to entering into a referral arrangement with a client. Other types of personal financial dealings, if permitted, may also necessitate additional measures, such as requiring the client to obtain independent advice before entering into a transaction.

As indicated in section XX02 of the Rule, situations may also arise where the interests of the parties cannot be reconciled and the Dealer Member would be expected to prohibit such transactions. As noted in previous enforcement actions, hearing panels have determined that registered representatives that borrow money from clients are engaging in business conduct which is unbecoming or detrimental to the public interest. Such activity should be prohibited, even where the amount of the loan may not appear to be material for a particular client.

Account suitability

Rule 1300 has been amended to expand the suitability obligations of the Dealer Member beyond the requirement to assess trade suitability at the time a trade is recommendation is made. The intent is to provide investors with an added level of protection in situations where the risk profile of the client and the account portfolio diverge over time. Amended Rule 1300.1(r) requires that the account suitability be reviewed when any of the following additional triggering events occurs:

- securities are transferred or deposited into the account,
- there is a change of representative on the account, or
- there is a material change to the know-your-client information for the account.

The general expectation of staff expectation is that all account suitability reviews required under Rule 1300 will be completed in a timely manner. In most cases, this means that the review should be completed within one day after the Dealer Member or its representative becomes aware of the fact that one of the triggering events noted in the Rule has occurred. Where warranted in a given case, such as a transfer of a block of accounts to a new advisor, a "reasonable time" standard would apply. In any case, the required account suitability reviews should be completed prior to, or at the time of, any subsequent trade on the account.

Staff does not expect that Dealer Members would perform reviews in situations where a change in client information is not material or the Dealer Member is not made aware of the change in circumstances. The Dealer Member's policies and procedures should address the issue of materiality and ways to encourage clients to provide updates on changes to client information.

Staff is in the process of considering further changes to the suitability requirements and providing guidance as to staff expectations for Dealer Member compliance. In some respects these will key off of amendments under the CRM project (such as the requirement to provide each client a copy of their KYC information and the requirement to supervise compliance with the new suitability requirements). Additional guidance to Dealer Members will be provided as part of this initiative.

Performance reporting

One of the most significant parts of the CRM project is the creation of new standards for performance reporting. Many Dealer Members have, for some time, provided performance reporting to clients as one of the services they offer. The amendments to Rule 200.1 now require that certain basic performance information be provided to all clients, as each client should have sufficient information to determine whether they have gained or lost money on the investments in their accounts. Specifically, Dealer Members are now required to provide security position cost information and account activity reporting.

Staff has noted a number of operation issues regarding performance reporting, and these have been discussed at length in the rule making process. Many issues were pointed out to staff with respect to potential problems with the quality and availability of historical data. To eliminate these issues, Rule 200.1 allows Dealer Members to report the required information as of the implementation date of the Rule.

As noted in the Guide to Interpretation of Rule 200.1, where a particular long security position has been determined by the Dealer Member to be not readily marketable, or the point in time market value for a security cannot be readily determined, costs information must not be reported for such securities and the client should be advised why the information is not being reported.

In some situations, cost information for securities previously provided to clients may be subject to subsequent adjustments. For example, this would apply to securities that have been subject to re-organizations. In such cases, the general rule to follow would be to adjust the security cost in line with the information provided by the issuer. Dealer Members may contact IIROC staff regarding questions on specific cases, if required.

Under Rule 200.1(e), account activity information must be provided to all retail clients on at least an annual basis. To meet the requirement, Dealer Members must disclose the cumulative realized and unrealized capital gains on the client's account. Again, the expectation is that this information will be reported on a go forward basis to avoid issues with historical data.

IIROC has not mandated that account percentage return information be provided to retail clients under the CRM amendments. However, under Rule 200.1(f), where a Dealer Member chooses to provide percentage return information to retail clients, the information must be reported on a 1, 3, 5 and 10 year basis and must be calculated in accordance with a method acceptable to IIROC.

For the purpose of the Rule, Dealer Members are advised that both dollar-weighted and time-weighted methods are acceptable to IIROC. In particular, this includes the Dietz and modified Dietz methods, daily valuation and any method permitted under the Global Investment Performance Standards endorsed by the CFA Institute.

IIROC staff intends to continue to study the cost and implementation issues surrounding percentage return reporting with the objective of requiring that this information be provided to clients at some point in the future. We will continue to work with IIROC Dealer Member firms in order to understand and address any existing impediments to the provision of this information to retail clients.