



CRM2 Reporting to Clients

and

Portfolio Manager - IIROC Dealer Member Service Arrangements

Presenters:

Andrea Maggisano, Legal Counsel, Compliance & Registrant Regulation Branch
Trevor Walz, Senior Accountant, Compliance & Registrant Regulation Branch

OSC

ONTARIO
SECURITIES
COMMISSION

Disclaimer

The presentation is provided for general information purposes only and does not constitute legal or accounting advice.

Information has been summarized and paraphrased for presentation purposes and the examples have been provided for illustration purposes only.

Information in this presentation reflects securities legislation and other relevant standards that are in effect as of the date of the presentation.

The contents of this presentation should not be modified without the express written permission of the presenters.

Agenda

1. Client Relationship Model Phase 2 (CRM2) Reporting to Clients
2. CSA Staff Notice 31-347: Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members (PMDSAs)
3. Questions and answers

Presentation Online

- Review of requirements
 - Client statements
 - Annual Reports
 - Report on charges & other compensation
 - Investment performance report
 - EMDs

Background

- The Client Relationship Model – Phase 2 (CRM2) amendments to NI 31-103 *Registrant Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and Companion Policy
- Introduced new requirements for reporting to clients about the costs and performance of their investments, and the content of their accounts
- Came into effect on July 15, 2013 and have been phased in over a three-year period – All transition periods are over
- The final amendments are the two new annual reports

Resources

- NI 31-103 *Registrant Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and Companion Policy
- CSA parallel orders dated May 2015 that provide interim relief from certain CRM2 provisions
- *CSA Staff Notice 31-345 Cost Disclosure, Performance Reporting and Client Statements – Frequently Asked Questions and Additional Guidance* dated April 14, 2016
- Proposed amendments to NI 31-103 that were published on July 7, 2016



Client Statements

OSC

ONTARIO
SECURITIES
COMMISSION

Client Statements - Ongoing Reporting

- Transaction information (s. 14.14(4))
 - At least quarterly
- Account position information (s. 14.14(5) or s. 14.14.1(2))
 - At least quarterly if
 - securities are held by the dealer or adviser
 - securities are held by another party and certain other conditions are met
- Security position cost information (s. 14.14.2)
 - At least quarterly if firm is required to provide account position information

Client Statements - Ongoing Reporting

- Firms must provide clients with a client statement for each of their accounts
- Consolidated statements can be sent *in addition*
- Flexible delivery requirements
 - No prescribed forms for the reports
 - Prescribed notifications in “substantially” the form in the rule

Transaction Information – s. 14.14(4)

- If firm made a transaction in the period, client statement must include:
 - (a) the date of the transaction;
 - (b) the type of transaction (e.g., purchase, sale, transfer, dividend or interest payment);
 - (c) the name of the security;
 - (d) the number of securities purchased, sold or transferred;
 - (e) the price per security;
 - (f) the total value of the transaction.
- A dealer that holds client securities has to send this information to a client at the end of the month

Transaction Information – Sample

Transactions

(For the period of October 1, 2016 to December 31, 2016)

Transaction Type	Trade Date	Description	Quantity	Price per Security	Total Value
BUY	20/10/2016	XYZ Fund	20	20.00	400.00
SELL	27/11/2016	123 Fund	20	30.00	600.00

Account Position Information – Depends on Who Holds Securities

- A firm holds securities if
 - it is the registered owner of the security as nominee on behalf of the client, or
 - it has physical possession of a certificate evidencing ownership
 - → s. 14.14(5) *Account Statement*
- A security is considered to be held by another party if
 - the other party is the registered owner of the security as nominee on behalf of the client,
 - ownership of the security is recorded on the books of the issuer in the client's name, or
 - the other party (which may be the client) has physical possession of a certificate evidencing ownership of the security
 - → s. 14.14.1 *Additional Statement*

If firm holds securities - s. 14.14(5)

- If firm holds securities owned by a client, the statement must include the following:
 - (a) the name and quantity of each security;
 - (b) the market value of each security;
 - (c) the total market value of each security position;
 - (d) any cash balance;
 - (e) the total market value of all cash and securities;
 - (f) whether the account is eligible for CIPF or IPC coverage;
 - (g) which securities might be subject to a deferred sales charge.
- The statement has to indicate that the firm holds the securities for the client.

If firm does not hold securities – s. 14.14.1

- “Additional” statements are required when securities are held by a party other than the firm **and** when:
 - the firm has trading authority;
 - the firm receives continuing payments tied to the securities (e.g., trailing commissions); or
 - the security is issued by a scholarship plan, a mutual fund or LSIF and the firm is the dealer/adviser of record.
- This information can be sent
 - combined in a statement with transaction information
 - in a separate statement accompanying the transaction information
 - in a separate statement sent within 10 days of the transaction information
- Carve-out for permitted client that is not an individual

“Additional Statement” – s. 14.14.1(2)

- The statement must include:
 - (a) the name and quantity of each security;
 - (b) the market value of each security;
 - (c) the total market value of each security position;
 - (d) any cash balance;
 - (e) the total market value of all of the cash and securities;
 - (f) disclosure about the party that holds or controls each security and the way it is held;
 - (g) whether the securities are eligible for coverage by CIPF or IPC;
 - (h) which securities might be subject to a deferred sales charge.
- PMs and EMDs are not required to provide (g) if the party in (f) provides this information (e.g., an IIROC member).

Account Position Information – Sample

Account Holdings					
(as at December 31, 2016)					
Security	Quantity	Book Cost	Market Value (per security)	Total Market Value	
XYZ Fund	20	400.00	25.00	500.00	
123 Fund	20	600.00	30.00	600.00	
ABC123 Corp.	20	800.00	45.00	900.00	
XYZ Co.	10	100.00	Not Determinable	-	
Total Securities		1900.00		2000.00	
Cash Balance				1000.00	
Total Market Value (Including Cash Balance)				3000.00	

Notes:

1. "X is the custodian that holds these securities as nominee for you" or "These securities are registered in your name at the fund company/the company that issued them".
2. Book cost means the total amount paid to purchase a security, including any transaction charges related to the purchase, adjusted for reinvested distributions, returns of capital and corporate reorganizations.

Market Value Methodology – s. 14.11.1

- Prescribed methodology for determining market value:
 - Security issued by an investment fund not listed on an exchange = NAV
 - Any other security = the amount reasonably believed to be its market value
 - A. If traded on an exchange = Last bid (long) or ask (short)
 - see FAQ
 - B. If no reliable price is quoted on a market place = use published market reports or inter-dealer quotes
 - C. If you cannot use A. or B. = use observable market data or inputs (e.g., market prices or yield rates for comparable securities and quotable interest rates)
 - D. If you cannot use C. = use unobservable inputs and assumptions (these are IFRS concepts)
 - E. If you cannot use D. = market value not determinable

Market Value Methodology – continued

- If firm uses observable inputs or unobservable inputs/assumptions to determine market value, the client statement must include a notification similar to the following
 - *"There is no active market for this security so we have estimated its market value."*
- If market value cannot be determined
 - in client statements – exclude from market value calculations and indicate that market value is not determinable
 - in investment performance report – assign a value of zero to the security and indicate that market value is not determinable

Security Position Cost – s. 14.14.2

- If a firm is required to provide account position information under s. 14.14(5) or s. 14.14.1(2), it will also be required to provide the position cost - Allows clients to compare the position cost to the market value
- Use either book cost or original cost – include the definition of whichever method you choose
- Security position cost information can be sent
 - combined in a statement with the account position information
 - in a separate statement accompanying the account position information
 - in a separate statement sent within 10 days of the account position information (however, market value information must also be included)
- Carve-out for permitted client that is not an individual

Security Position Cost - When is a security position “opened”?

- Position cost reporting requirements differ depending on when the security was “opened”
- A security position is “opened” when the firm that is providing the statement first acquires or holds securities for the client or first has trading authority of the securities
- Examples:
 - A firm purchases a security for a client’s account on February 21, 2017 – the security position was opened on February 21, 2017
 - A client transfers a security to its account at a firm on December 1, 2017 – the security position was opened on December 1, 2017

Security Position Cost – Post July 15, 2015

- For positions opened on or after July 15, 2015 firms can use:
 1. The cost of the security (either book cost or original cost) or,
 2. If the security was transferred in from another firm, either:
 - a. the cost of the security (if firm has this information), or
 - b. the market value of the security on the date of the transfer
- If market value is used, statement must disclose this

Security Position Cost – Pre July 15, 2015

- For positions opened before July 15, 2015 firms can use
 1. The cost of the security (either book cost or original cost),
 2. The market value of the security as at December 31, 2015, or
 3. The market value of the security as at an earlier date if the firm has reliable information
- If market value is used, statement must disclose this

Sample Position Cost Disclosure

Book cost means the total amount paid to purchase a security, including any transaction charges related to the purchase, adjusted for reinvested distributions, return of capital and corporate reorganizations.

Because book cost information for [this] security position was unavailable, we have used market value information as of the transfer date as the position cost.

Security Position Cost - Successive Transactions

- Successive transactions – holdings of a security that involved multiple purchases (or transfers)
 - An average can be used to determine the cost of the position
 - The average may include both book/original cost information used for some of the transactions and market value used for others
 - Disclosure is required
 - Can also report positions valued at book cost or original cost separately from those where market value was used, instead of averaging them into a single number - potentially confusing to clients, so clear explanatory notes should be provided if this method is used

Sample Successive Transaction Disclosure

The cost of this security position has been determined using an average of market value as of the date on which some securities were transferred into your account when it was opened, and the book cost of securities that we subsequently purchased for your account.

Client Statements – Special Cases

- Security holder statements
 - If there is no dealer or adviser of record for a security holder on the records of an IFM (orphaned accounts)
 - The IFM must deliver the following annually:
 - transactional information (14.14 (4))
 - information on account positions (14.14.1(2))
 - position cost information (14.14.2)
- Scholarship plan dealer statements
 - If not registered in another dealer or adviser category, deliver annually
 - transactional information (14.14 (4))
 - information on account positions (14.14.1(2))



Annual Reports

Annual Report on Charges & Other Compensation

- For each 12-month period, a report that shows, in dollars, what the dealer or adviser was paid for the products and services it provided, and other financial incentives received, including
 - operating charges
 - transaction charges
 - payments received from issuers or other registrants
 - e.g., referral fees or success fees
 - trailing commissions
 - information re: debt security transactions
- Sample report in Appendix D of companion policy to NI 31-103

Annual Investment Performance Report

- For each 12-month period, a report that covers
 - market value of cash and securities at the beginning and end of period
 - market value of deposits into, and withdrawals from, the client's account in the period and since opening the account
 - change in market value of the account over the period and since opening the account
 - annualized total percentage returns using a money weighted rate of return
 - for 1, 3, 5 and 10 years and since inception
 - can use time-weighted rate of return *in addition* – but must explain the difference
- Sample report in Appendix E of companion policy to NI 31-103

Annual Investment Performance Report – Accounts opened before July 15, 2015

- Deemed account opening/inception dates
 - Reporting on a calendar year basis with first report covering 2016 – January 1, 2016
 - Reporting on another 12-month period – July 15, 2015
 - firms can choose an earlier date if they have reliable information
 - firms can use different deemed account opening dates for different accounts if it is reasonable (e.g., two separate record keeping systems for two groups of accounts)
- firms are not required to report annualized total percentage returns for periods before July 15, 2015

Personal Rate of Return

- Calculation using money-weighted rate of return is required
 - no approved formula – firms must use a method that is generally acceptable in the securities industry
- Firm can also show time-weighted rate of return but a plain language explanation of the differences between the two is required
- Approximation methods such as Modified Dietz are not acceptable

Delivery of Annual Reports

- The report on charges and other compensation and the investment performance report must include information for the same 12-month period
- They can be delivered combined with, accompanying or within 10 days of the client statements
- Carve-out for permitted client that is not an individual
- For the investment performance report, also a carve out for
 - Client accounts less than 12-months old
 - Dealer executing trades as directed by an adviser
- Reports for more than one of the same client's accounts can be consolidated into a single report with client consent

Dates for Annual Compensation and Performance Reports

- Calendar year basis
 - first reports will cover January 1, 2016 - December 31, 2016
 - reports will have been sent in January 2017
- Alternative 12-month period ending as late as July 14, 2017
 - reports will be sent with the quarterly client statement



EMDs

EMDs – What do you need to know?

- CRM2 requirements are applicable to all dealers and advisers
- Any differences will be the result of different operating models
- Some EMDs have only limited, transactional relationships with their clients – in these cases, many CRM2 requirements may not be triggered

EMDs – What do you need to know?

- Transaction information (s. 14.14(4))
 - Always required where there has been a transaction
- Account position information – not required unless
 - firm holds client assets (s. 14.14(5)) or
 - firm does not hold client assets (s. 14.14.1) but
 - receives continuing payments (e.g., trailing commissions) or
 - is the dealer of record for securities issued by a mutual fund or certain labour-sponsored investment vehicles
- Position cost information only if account position information is required (s. 14.14.2)

EMDs – What do you need to know?

Annual Reports

- If an EMD is required to provide account position information under s. 14.14(5) or s. 14.14.1(2), it will also be required to send the annual reports
- No nil Report on Charges and other Compensation required
- No Investment Performance Report required if market value cannot be determined for any securities under s. 14.14(5) or s. 14.14.1(2)



CSA Staff Notice 31-347:

Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members (PMDSAs)

Overview

- Background on PMDSAs
- Key points in CSA Staff Notice 31-347
- Other considerations

Background on PMDSAs

- Arrangement between a portfolio manager (PM) and an IIROC dealer member (DM) where the DM provides custody, trading and other services to the PM and its clients (PMDSA)
- Investor is client of both PM and DM
- PM and DM have different roles and responsibilities, so have different regulatory obligations
- But both PM and DM have client recordkeeping and client statement obligations

Background on PMDSAs (cont'd)

- PMDSAs more widespread & have changed
- Concerns identified, including:
 - some PMs relying on the DM's books and records as a substitute for maintaining its own records of clients' investment positions and trades
 - some PMs using the DM's delivery of custody statements to satisfy its statement delivery obligations to clients, without adequate oversight
- No specific regulatory framework
- CSA and IIROC working group formed
- Consultation with CIPF

CSA Staff Notice 31-347 (Notice)

- Published Nov. 17, 2016
- Notice replaces interim guidance on PM client account statement practices in OSC Staff Notice 33-742
- Purpose:
 - address identified concerns with PMDSAs
 - add consistency and clarity for PMDSAs
 - provide guidance to help PMs under a PMDSA comply with regulatory obligations in NI 31-103, including when only the DM sends the client statements



Key Points in Notice

1. Books and records

A PM must maintain its own records of its client's investment positions and trades, and may not rely on a DM's records as a substitute for its own records

2. Agreement

We expect the PM and DM to have a written agreement on the PMDSA that covers:

- the key terms
- roles and responsibilities of the PM and DM

3. Disclosure to clients

We expect PM to provide written summary disclosure on the PMDSA to relevant clients:

- purpose and material terms
- key services provided to the client
- key obligations owed to the client
- within one year

3. Disclosure to clients (cont'd)

If PM doesn't issue its own client statements since DM does, then disclosure should also:

- inform client of this,
- state both PM and DM are responsible for ensuring info on DM's statement is complete and accurate, &
- provide details for contacting the PM if the client has any questions about info on the DM's statement

4. When PM must deliver its own statements

- If PM holds any investments for a client
- If a client requests a statement from the PM
- If a client agreement states that statements from PM will be issued, in addition to statements from the DM

5. How a PM may satisfy its statement obligations when only DM sends a statement

- PM does not hold any of a client's investments and verifies all investments it manages are held at DM
- PM confirms statement is sent to the client by the DM with required content and at required frequency
- PM verifies, such as through reconciliations, that content of DM's statement is complete and accurate
- PM has written policies and procedures to ensure it has taken the above steps



Other Considerations

Other PM client reporting

- PMs also have annual investment performance and charges & compensation reporting obligations in NI 31-103
- These reports are to be issued under PM firm's name
- If PM does not send own client statements, market values for PM's annual investment performance reports should be same as used by DM on its statements

Other points

- Many PMs send their own client statements, in addition to statements from the DM
- If PM sends its own client statements, should be fully compliant with NI 31-103 (sections 14.14, 14.14.1, 14.14.2)

Outsourcing of statements

- Guidance in Notice applies to PMDSAs
- Existing guidance in 31-103CP on outsourcing of client statements continues to apply
- 31-103CP permits production and delivery of account and additional statements by a registered firm to a third-party service provider that acts as its agent
- For example, a PM may outsource preparation and delivery of client statements to a financial institution custodian if it meets expectations in 31-103CP
- These statements should also be fully compliant with sections 14.14, 14.14.1 and 14.14.2 of NI 31-103

Key outsourcing expectations in 31-103CP

- responsible & accountable for functions outsourced to service provider (SP)
- supervise the SP
- written, legal binding contract with SP, including expectations of each party

Resources

PMDSAs:

- CSA Staff Notice 31-347 *Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members*

Outsourcing:

- Parts 11 and 14 of 31-103CP



Questions

RegistrantOutreach@osc.gov.on.ca

Contact Centre:

inquiries@osc.gov.on.ca

416-593-8314 or

1-877-785-1555 (toll free)

