

1.1.3 OSC Staff Notice 33-723 - Fair Allocation of Investment Opportunities - Compliance Team Desk Review

**OSC STAFF NOTICE – 33-723
FAIR ALLOCATION OF
INVESTMENT OPPORTUNITIES
COMPLIANCE TEAM DESK REVIEW**

What we did and why

Staff of the Compliance team of the Ontario Securities Commission (OSC) recently completed a desk review of the fairness policies and related business practices of approximately 40 investment counsel/portfolio managers (ICPMs).

Regulation 115 of the *Securities Act* (Ontario) requires ICPMs to treat clients fairly in allocating investment opportunities and to file a copy of their current fairness policy with the OSC.

The OSC has received comments from the public regarding the use of “generic” fairness policies by ICPMs. The generic policies do not clearly set out how ICPMs allocate investment opportunities for the types of activities carried on. The Compliance annual reports for fiscal 2002/2003 and 2003/2004 indicate that a significant number of ICPMs examined during the periods had deficiencies in their fairness policies.

How we did it

The Compliance team of the OSC conducted a desk review of the fairness policies and related business processes of approximately 40 ICPMs. A desk review is a review completed at OSC offices by OSC staff of information provided by a group of selected market participants. No on site field review is performed and our follow up on the information provided is limited to written and verbal requests for additional information or clarification of information already provided.

Each ICPM was asked to complete a questionnaire and provide a copy of its most recent fairness policy. No review of actual trades was completed. The questionnaire included questions regarding preparation, filing and amendments to the fairness policy and questions regarding specific policies to ensure fair allocation of investment opportunities, such as:

- whether the ICPM uses block trades and, if so, how fills are allocated and the method used to allocate fills
- whether the ICPM includes proprietary, employee and/or personal accounts with block trades for clients
- whether the ICPM participates in initial public offerings (IPOs) and, if so, how fills are allocated and the method used to allocate fills

What we found

The following disclosure or filing deficiencies were noted:

- 74% of the fairness policies were missing one or more of the disclosures set out below under “What should be in an ICPM’s fairness policy?”
- 26% of the fairness policies currently in use had not been filed with the OSC. Since the filing of a fairness policy is required prior to registration being granted, all registrants surveyed should have filed at least one previous fairness policy with the OSC.
- 26% of the fairness policies currently in use had not been provided to clients.
- 15% of the fairness policies were “generic” policies. Some of the fairness policies filed appeared to be identical (other than the name of the registrant). As a result, it wasn’t clear to staff whether the “generic” policies reflected the actual practice of the ICPM in allocating investment opportunities for the types of activities carried on in its business.

All of the ICPMs with disclosure or filing deficiencies have rectified their deficiencies. Staff ensured that any “generic” policies filed accurately reflected the actual practice of the ICPM.

As well, 9% of the ICPMs included proprietary, employee and/or personal accounts in block trades and allocated a pro-rata share of partially filled blocked trades or IPOs to proprietary, employee and/or personal accounts. All of these ICPMs have now amended, or will be amending, their fairness policies and their practices so that proprietary, employee and/or personal accounts are not allocated a pro-rata share of partially filled blocked trades or IPOs before clients trades are completely filled.

Finally, where an ICPM has contracted advisory services to a subadvisor, the ICPM should monitor the subadvisers’ compliance with the ICPM’s fairness policy. No issues were noted regarding subadvisers’ compliance with ICPMs’ fairness policies.

What should be in an ICPM’s fairness policy?

The following disclosures should be included in an ICPM’s fairness policy, where applicable to its investment processes.

- method used to allocate price and commission among clients when trades are bunched or blocked.
- method used to allocate block trades and IPOs among client accounts.

method used to allocate block trades and IPOs among clients that are partially filled (e.g. pro-rata).

What we'll do in the future and what we expect in the future

Staff will continue to monitor compliance by ICPMs with Regulation 115 as part of our regular compliance field reviews.

Staff expects ICPMs to enhance their compliance with Regulation 115 and that fewer deficiencies will be found in future compliance field reviews in this area. Staff will take seriously any deficiencies found in future compliance field reviews.

Staff also expects that improved documentation of policies and procedures will result in increased fairness in the allocation of investment opportunities to clients by ICPMs.

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