



May 13, 2016

## **Implementation of Requirements under CRM2 Phase 2 Amendments to NI 31-103 – Frequently Asked Questions (FAQs)**

Set out below, are frequently asked Member questions and MFDA staff responses respecting the implementation of CRM2 requirements under NI 31-103. The purpose of this document is to provide Members and Approved Persons with additional guidance and clarification in respect of these matters so as to assist them in complying with their obligations under MFDA Rules and securities legislation.

### **Determining Cost (Rule 5.3)**

#### Book Cost

1. In certain circumstances, a client may make purchases of an investment and subsequently transfer in more units of the same position. Where market value is used for the transferred in positions, would the new book cost of the position be an average of book cost for purchases and the market value as at date of transfer for positions transferred in?

#### ***MFDA Response***

*Members should first make a reasonable effort to obtain information respecting the book cost of investment positions transferred in. For investment funds, this may involve the Member obtaining the information from the fund company. Where such information cannot be obtained, Members may use the market value of the investment position as at the date of the position's transfer. Where the cost of a client's position in an investment is arrived at by using an average of both book cost and market value, Members must provide clients with general disclosure in respect of this matter. Such disclosure may be located in the notes to the account statement and, as appropriate, should set out that an estimated book cost has been used and that this cost was arrived at by combining and averaging the book cost of positions purchased and market value of positions transferred in, as at the date of transfer.*

2. For new accounts, a client's position in an investment may be associated with multiple transfer in dates. Rule 5.3(1)(c)(ii) states that cost may be determined using the market value of the investment position as at the date of the position's transfer. How should Members comply with the requirements of Rule 5.3(1)(c)(ii) where there are multiple transfer in dates associated with an investment position?

May 13, 2016

### ***MFDA Response***

*As noted above, for investment funds, Members should first make a reasonable effort to obtain, from the fund company, information respecting the book cost of investment positions transferred in. Where such information cannot be obtained, and the Member has determined in accordance with Rule 5.3(1)(c)(ii), that it is appropriate to use market value, the Member may use the market value of the investment position as at the date of each respective transfer in. Rule 5.3(1)(c)(ii) does not require that the date of each transfer in be disclosed. However, in accordance with the requirements of the Rule, the account statement must include general disclosure that it is the market value as of the transfer date(s), not the cost of the investment position(s) that are being disclosed.*

3. In certain circumstances, the transfer in of an investment position is a taxable event (e.g. deregistration from a registered account with a transfer to a non-registered account). In such circumstances, the book cost is generally reset to the transfer in price. Are Members required to provide some form of disclosure to the client noting that, in these specific circumstances, the book cost is the market value of the investment position as at the date of the position's transfer?

### ***MFDA Response***

*Yes. In such circumstances, the book cost would be the market value of the investment position, plus any applicable transaction charges, as at the date of the position's transfer. The Member would also be required to disclose that book cost has been reset to the date of the transfer in, as a result of deregistration of the position.*

4. When switching between corporate class funds, the adjusted cost base of the newly acquired shares equals the adjusted cost base of the switched shares (i.e. the adjusted cost base transfers over). In such circumstances, is it acceptable for Members to determine book cost on the same basis as adjusted cost base or does book cost have to be recalculated?

### ***MFDA Response***

*Such switch transactions may involve the sale and purchase of two completely different securities. As a result, book cost for the new securities purchased should be recalculated.<sup>1</sup>*

5. In certain circumstances, units in a client's mutual fund may be switched to units of a different series of the same fund. Would such switch transactions, where the underlying securities remain the same, require book cost to be recalculated?

---

<sup>1</sup> The 2016 Federal Budget introduces *Income Tax Act* changes in this area that will come into effect on October 1, 2016. As of October 1<sup>st</sup>, a switch between classes of shares of a mutual fund corporation will be considered to be a disposition at fair market value for tax purposes (i.e. as of October 1, 2016, adjusted cost base will not be transferrable when switching units in corporate class funds). The change will not apply to switches between different series of the same share class.

***MFDA Response***

*In such circumstances, book cost should not be reset. In these situations, there is no change in the underlying securities, only a change to the cost structure. Any series switch that does result in a fee or charge being applied would require a recalculation of book cost to include the fee or charge, but book cost should not be reset to current market value.*

**Account Statements (Rule 5.3.1 – 5.3.2)**

**Disclosure of Positions Valued at Book Cost and Positions Valued at Market Value**

6. A Member may decide generally to use book cost but, in certain circumstances, book cost of an investment position may not be available. As a result, it may become necessary to value such positions using market value. Account statements will, accordingly, reflect positions valued at book cost and positions valued at market value. In such circumstances, is it acceptable to provide general disclosure noting that certain positions have been valued at market value because book cost was unavailable? Alternatively, would more specific disclosure be required?

***MFDA Response***

*General disclosure would not be sufficient. The account statement must identify which positions have been valued at book cost and which positions have been valued using the market value of the investment position as at the date of its transfer.*

**Use of Trade vs. Settlement Date**

7. Are references to “date”, as set out under Rule 5.3.2 (Content of Account Statement), intended to refer to trade date or settlement date?

***MFDA Response***

*Trade date is to be used for the purpose of meeting client reporting requirements under Rule 5.3, including those in respect of account statement content, as prescribed under Rule 5.3.2.*

8. For the purpose of determining transactions to be included in the account statement, is trade or settlement date to be used as the cutoff?

***MFDA Response***

*Trade date is to be used. For example, a quarterly account statement covering the period from January - March, should include all transactions with trade dates from January 1<sup>st</sup> to March 31<sup>st</sup>.*

## How Investments are Held and Controlled

9. Rule 5.3.2(c)(ii)(H) requires the account statement to include disclosure of **the name of the party** that holds or controls each investment and a description of the way it is held. Is it acceptable to satisfy this requirement by way of more general disclosure?

### ***MFDA Response***

*Yes. Rule 5.3.2 and NI 31-103 will be amended to permit more general disclosure. Set out below are examples of general disclosure that MFDA staff would consider acceptable.*

<i>Account Type</i>	<i>Investments Held in Account</i>	<i>Sample Disclosure</i>
<i>Client Name</i>	<i>Only mutual funds</i>	<i>These investments are registered in your name at the fund company.</i>
<i>Client Name</i>	<i>Only mutual funds of a related (or integrated) fund company</i>	<i>These investments are registered in your name at [insert name of related issuer].</i>
<i>Client Name</i>	<i>Mutual funds and other investments</i>	<i>These investments are registered in your name at the issuer.</i>
<i>All Member Nominee Name accounts</i>	<i>Mutual funds and other investments</i>	<i>These investments are registered in the name of [insert Member name] on your behalf.</i>
<i>All Carrying Dealer/Intermediary Accounts</i>	<i>Mutual funds and other investments</i>	<i>These investments are registered in the name of the carrying dealer/intermediary [insert carrying dealer or intermediary name] on your behalf.</i>

## **Charges and Compensation Disclosure (Rule 5.3.3)**

### Referral Fees

10. If an individual is referred to a Portfolio Manager and on-going referral fees are received by the Member for the assets transferred to the Portfolio Manager, are those fees required to be included on the Report on Charges and Other Compensation if that individual is no longer a client of the Member?

### ***MFDA Response***

*No. Where an individual is no longer a client of the Member, the Member is not required to send a Report on Charges and Other Compensation.*

11. If a client is referred to a Portfolio Manager but remains a client of the Member, and on-going referral fees are received for the assets transferred to the Portfolio Manager, can the Member rely on the Portfolio Manager to provide disclosure of the referral fees paid to the Member?

***MFDA Response***

*Yes. Where a client has been referred to a Portfolio Manager, the Member may rely on the Portfolio Manager to provide disclosure of the referral fees, provided that the Member satisfies itself that the Portfolio Manager is providing adequate disclosure within the Report on Charges and Other Compensation that it provides to the client. At a minimum, adequate disclosure would include the name of the Member and the specific amount of the referral fee paid by the Portfolio Manager to the Member.*

12. If, on an unsolicited basis, a client is referred to an IIROC firm to purchase or sell a security in which the MFDA Member is not licensed to trade, can the Member rely on the IIROC firm to provide disclosure of the compensation paid to the Member?

***MFDA Response***

*Yes. Where a client has been referred to an IIROC firm, the Member may rely on the IIROC firm to provide disclosure of the compensation paid, provided that the Member satisfies itself that the IIROC firm is providing adequate disclosure within the Report on Charges and Other Compensation that it provides to the client. At a minimum, adequate disclosure would include the name of the Member and the specific amount of the compensation paid by the IIROC firm to the Member.*

13. If the Member cannot satisfy itself that adequate disclosure of the referral fees is being provided by the IIROC firm or Portfolio Manager, and where the client has multiple accounts with the Member, does the Member have to include the disclosure of the fee on **each** Report on Charges and Other Compensation prepared for the client?

***MFDA Response***

*No. Where the Member prepares a Report on Charges and Other Compensation for each account of the client, referral fees may be disclosed within, or as an addendum to, any **one** of such Reports.*

14. If an introducing dealer receives referral fees and is relying on the carrying dealer to prepare and deliver the Report on Charges and Other Compensation, how can the carrying dealer include the disclosure of referral fees received by the introducing dealer?

***MFDA Response***

*If the introducing dealer cannot satisfy itself that adequate disclosure of the referral fees is being provided by the IIROC firm or Portfolio Manager, then the introducing dealer will either need to develop systems/processes to share the information with its carrying dealer or will need to send a supplemental Report on Charges and Other Compensation to the client that discloses the referral fees earned.*

## Sales Taxes

15. Where sales taxes are applied in respect of an amount charged to a client, are such taxes required to be included on the Report on Charges and Other Compensation?

### ***MFDA Response***

*Yes. Amounts reflected on the Report on Charges and Other Compensation include, “operating charges” and “transaction charges”. The definitions of these terms, as set out under Rule 5.3, note that they include any federal, provincial or territorial sales taxes paid on such amounts. Where amounts other than operating or transaction charges are reportable on the Report on Charges and Other Compensation, sales taxes applied in respect of such other amounts would also be required to be reported.*

## Fees/Charges Represented as Transactions on Account Statement

16. If a fee/charge is represented as a transaction on the account statement, is that amount still required to be reported on the Report on Charges and Other Compensation?

### ***MFDA Response***

*Yes, where the amount was paid to the Member. Disclosure on the Report on Charges and Other Compensation would not be required in respect of transactions reflecting fees and/or charges paid to parties other than the Member (e.g. redemption charges paid to the fund company). However, in the interests of providing consistent reporting to clients, Members may decide to include such third party charges and compensation in the Report.*

## Rebated Fees

17. If a fee is charged to a client but rebated (i.e. paid by the advisor), may such an amount be represented as a reduced or eliminated fee on the Report on Charges and Other Compensation?

### ***MFDA Response***

*Yes. However, the gross amount of the fee and rebate should be shown separately.*

## Reporting of Transfer Payments Received from Affiliates

18. Certain MFDA Members are part of large, integrated corporate groups. In certain circumstances, Members who are part of such corporate groups do not receive commission revenue. Instead, such dealers receive internal transfer payments from affiliates based upon a management agreement with the corporate group. In circumstances where the Member receives transfer payments which are not directly tied to activity in client accounts, what should be reported on the Charges and Compensation Report? If compensation has to be disclosed, how are Members expected to determine the amount?

## **MFDA Response**

*MFDA Rule 5.3.3(1)(f) requires the Charges and Compensation Report to include:*

*“...the total amount of each type of payment, other than a trailing commission, that is made to the Member or any of its Approved Persons by a securities issuer or another registrant in relation to registerable services to the client during the period covered by the report, accompanied by an explanation of each type of payment”*

*Pursuant to Rule 5.3.3(1)(f), Members are required to determine and provide fair and reasonable disclosure in respect of costs associated with registerable services provided to the client, even in circumstances where such Member revenue is not directly tied to account activity. Members who receive transfer payments instead of commission revenue must make a reasonable estimate of what the Member would have received if it earned commission revenue. For example, Members can base their estimate on compensation that would have been earned by third party dealers from the sale of the same or similar products.*

*Alternatively, some integrated Members currently disclose total costs paid by the client to the combined corporate entity, which includes revenue earned by the corporate group for both product management and dealer services. This approach would also meet the requirements of Rule 5.3.3.1(f).*

*In either case, the description should be sufficiently clear so as to provide clients with an understanding of the services to which the compensation relates.*

## **Performance Reporting (Rule 5.3.4 / Policy No.7)**

### **Selection of Performance Reporting Inception Date**

19. Is a Member permitted to choose any performance reporting inception date?

## **MFDA Response**

*Where a Member selects a performance reporting inception date that is other than the inception date of the account or December 31, 2015, assuming a calendar year basis of reporting, the Member should have a reasonable basis for their selection. For example, there may have been a system conversion at the Member and information dating back to the inception date of the account may not be available. Members may not select an earlier performance reporting inception date, for example January 1, 2010, solely on the basis that use of that date would allow the Member to present better returns. MFDA staff would consider any such selection to be inappropriate and contrary to the obligation of the Member to deal fairly, honestly and in good faith with its clients.*

20. Whether the performance reporting since inception date is based on the actual account opening date or some other reasonable date, is a Member required to include the specific date used on the performance report?

### ***MFDA Response***

*If the Member uses the actual date that the account was opened as the inception date, disclosure of that date does **not** have to be provided on the performance report. However, if a date other than the actual inception date is used (e.g. a deemed inception date), disclosure of that other date must be provided on the performance report.*

### Reporting Cash Positions

21. May cash positions be excluded from the rate of return calculation?

### ***MFDA Response***

*No. Cash positions may not be excluded from the rate of return calculation.*

### Reporting for Periods of Less than One Year

22. If the rate of return is for less than a one year period, should it be presented on an annualized or non-annualized basis?

### ***MFDA Response***

*As set out under Policy No.7, there is no requirement to present a rate of return for a period of less than one year. However, where Members choose to provide such information, it must be presented on a non-annualized basis (i.e. only for the period covered by the report).*

### Valuation of Non-Security Investment Products

23. For investments such as GICs (compounding and non-compounding), annuities and mortgages, clarification is sought with respect to pricing and potential disclosure requirements, as there is no active market for these types of products.

### ***MFDA Response***

#### *Valuation of GICs*

*Members currently report the value of GICs as the principal amount plus accrued interest, earned as at the end of the account statement period. This method of reporting will continue to be permitted. For market-linked GICs, Member reporting would include an estimate of the accrued interest, along with an explanation that sets out the basis for the estimate.*

#### *Valuation of Investments Generally*

*Changes have been made to MFDA Form 1, Part 5 (Market Value of a Security). These changes include requirements prescribed under NI 31-103 respecting the determination of market value. Form 1, Part 5, as amended, is based on the International Financial Reporting Standards (“IFRS”) hierarchy approach to assessing the fair value of financial instruments. Accordingly, when determining the market value of investments, including GICs, annuities and mortgages,*



*Members should consider both IFRS fair value standards and the “market value of a security” definition set out under Form 1, as revised.*

*Where Members require additional guidance and clarification respecting the valuation of any investment product, for the purpose of meeting reporting requirements under MFDA Rules, we would encourage Members to discuss such matters with MFDA staff.*

#### *Disclosure*

*The valuation of all investments transacted through the Member or held in an account at the Member, including non-security investment products, such as annuities and GICs, are subject to the requirements of MFDA Rule 5.3. Accordingly, Members must provide appropriate disclosure of any assumptions, as specified under the Rule (e.g. where market value has been estimated or the Member has determined, after applying the valuation approaches noted above, that market value is not determinable).*

24. For segregated funds, where the value of the fund has dropped below the guarantee amount, are Members required to disclose the net asset value (i.e. market value) of the fund or the amount of the guarantee?

#### ***MFDA Response***

*Members are required to disclose the net asset value (i.e. the market value) of the fund. Members, at their option, may also provide additional note disclosure respecting the guarantee amount.*

#### Calculation of Annual Change in Market Value

25. Policy No. 7, Content of Performance Report, section 1(f) prescribes requirements in respect of the annual change in the market value of a client’s account for the 12 month period covered by the report. The prescribed formula under this section makes reference to the market value of all cash, investments, deposits and transfers “*in / into the account*” and withdrawals and transfers “*out of the account*”. How is the annual change in market value to be calculated for transactions that occur outside of the Member (e.g. cash dividends, interest payments or direct payments from the client to the dealer) as, in such circumstances, neither cash nor investments actually come in, into or go out of the client’s account at the Member?

#### ***MFDA Response***

*For the purpose of performance reporting requirements under Rule 5.3.4 / Policy No. 7, any such transactions should be treated as if they were done through the Member (i.e. in the same manner as nominee name transactions).*

## **Trade Confirmations (Rule 5.4)**

### **Reliance on Fund Company**

26. May Members still rely on fund companies to produce and mail trade confirmations on their behalf?

#### ***MFDA Response***

*Yes. Such reliance will continue to be permitted under MFDA Rule 5.4.1 (Delivery of Confirmations), provided that: the written confirmation sent by the fund manager contains the information required to be sent under Rule 5.4.3; and the Member has a reasonable basis to believe that such confirmations are being sent by the fund manager.*

## **Other Related Matters**

### **Scope of Reporting**

27. When are segregated funds required to be included on account statements under Rule 5.3.2?

#### ***MFDA Response***

*Under Rule 5.3.2, account statements must include prescribed information in respect of all securities and other investment products transacted through, or transferred into, the Member. Under Rule 5.3.4, performance reporting is required to be provided in respect of all investments required to be reported on the account statement.*

28. Are charges and compensation related to segregated funds required to be disclosed on the Report on Charges and Other Compensation?

#### ***MFDA Response***

*No, charges and compensation disclosure, as required under Rule 5.3.3, must be provided in respect of transactions in securities.*

*In the interests of providing more fulsome reporting to clients, and where reliable data is available, we would encourage Members to provide disclosure on the Report on Charges and Other Compensation in respect of non-securities investment products. Such disclosure will further assist investor decision-making and is consistent with the obligation of Members to deal fairly, honestly and in good faith with their clients.*

### **Application of Client Reporting Requirements to Intermediary Arrangements**

29. Are intermediary accounts required to be reported on Member account statements? If so, which party has the reporting obligation?

## ***MFDA Response***

*There are two types of intermediaries: those who are carrying dealers and MFDA Members; and intermediaries who are not MFDA Members.*

*Where a Member is using the services of a carrying dealer that is also an MFDA Member, the carrying dealer is responsible for sending all client reporting required under MFDA Rule 5.3 (i.e. account statements, the Report on Charges and Other Compensation and Performance Report). We will be amending Rule 1.1.6 (Introducing and Carrying Arrangement) to clarify the obligations of MFDA carrying dealers in such circumstances. However, where the intermediary is not an MFDA Member, the Member using their services has the obligation to develop and send all client reporting required under Rule 5.3.*

DM#509350