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## **MFDA STAFF NOTICE**

### **RELATIONSHIP DISCLOSURE**

*MFDA Staff Notices are intended to assist Members and their Approved Persons in the interpretation, application of and compliance with requirements under MFDA By-laws and Rules. Notices make reference to these requirements and set out MFDA staff's interpretation of how to comply with these requirements. Notices may also include best practices or guidance.*

This Notice is intended to clarify the obligations of Members with respect to the requirement to provide relationship disclosure information pursuant to Rule 2.2.7. The Rule requires that, on account opening, Members provide all clients with core information about the nature of their relationship with the Member and its Approved Persons. The objective of the relationship disclosure requirement is to ensure that clients understand their obligations, the obligations of their dealer and know what to expect with respect to service levels and costs.

#### **Form of Relationship Disclosure**

Rule 2.2.7 prescribes the core elements of disclosure that must be provided to clients at account opening. The format of the relationship disclosure is not prescribed, but it must be provided to the client in writing and in plain language. The disclosure may be a stand-alone document or incorporated into other documents provided to the client at account opening.

Members are given the flexibility to provide customized relationship disclosure to each client or provide appropriate standardized relationship disclosure to all clients or separate classes of clients.

Members may provide the relationship disclosure to clients through electronic means provided requirements under securities legislation are satisfied. Members may refer to National Instrument 11-201 *Delivery of Documents by Electronic Means* for more information.

#### **Content of Relationship Disclosure**

Rule 2.2.7(1) requires that, for each new account opened, the Member shall provide written disclosure to the client:

- (a) describing the nature of the advisory relationship;

- ~~(b)~~ — describing the products and services offered by the Member;
- ~~(e)~~(b) that provides a general description of the products and services the Member will offer to the client, including: (i) a description of the restrictions on the client’s ability to liquidate or resell a security; and (ii) a statement of the investment fund management expense fees or other ongoing fees the client may incur in connection with a security or service the Member provides;
- ~~(d)~~(c) that provides a general description of any limits on the products and services the Member will offer to the client, including whether the Member will primarily or exclusively offer proprietary products to the client, and whether there will be other limits on the availability of products or services;
- ~~(e)~~(d) describing the Member’s procedures regarding the receipt and handling of client cash and cheques. In the case of a Level 2 dealer, the disclosure must include an explanation that all client cheques shall be payable to the issuer or carrying dealer, as applicable;
- ~~(f)~~(e) stating that the Member must determine that any investment action it takes, recommends or decides on, for the client is suitable and puts the client’s interest first;
- ~~(g)~~(f) defining the various terms with respect to the Know-Your-Client (“KYC”) information collected by the Member and describing how this information will be used in assessing investments in the account;
- ~~(h)~~(g) describing the content and frequency of reporting for the account;
- ~~(i)~~(h) that provides a general description of any benefits received, or expected to be received, by the Member or Approved Person from a person or company other than the client in connection with the client’s purchase or ownership of an investment through the Member or Approved Person;
- ~~(j)~~(i) disclosure of the operating charges that the client might be required to pay related to the client’s account;
- ~~(k)~~(j) describing the type of transaction charges, as defined under Rule 5.3(1), that the client might be required to pay;
- ~~(l)~~(k) that provides a general explanation of the potential impact on a client’s investment returns from investment fund management expense fees, other ongoing fees, operating charges, or transaction charges, including their compounding effect over time; and
- ~~(m)~~(l) including a general explanation of how investment performance benchmarks might be used to assess the performance of a client’s investments and any options for benchmark information that might be available to clients by the Member.

- Nature of the Advisory Relationship

The relationship disclosure must include a brief description of the nature of the advisory relationship and how it operates. For example, this may include a statement that the client is responsible for making investment decisions but can rely on the advice given by the Approved Person, and that the Approved Person is responsible for the advice and ensuring that it is suitable based on the client’s investment needs and objectives.

Disclosure under this section should include basic information about the type of account (e.g. if commissions will be payable, whether the account is fee-based, and whether there are any limits based on the type of account). Examples of relevant information also include whether there is a minimum account size or whether there are limits on what products or services are made available

for accounts of that type.

- NatureGeneral Description of the Products and Services Offered

A description ~~of the nature~~ of the products and services offered by the Member must be provided. Members may provide a generic description of the type or class of products sold (e.g. mutual funds, guaranteed investment certificates, principal protected notes, exempt market securities).

Members must also provide a general description of any limits on the selection of the products and services the Member will offer to the client, including whether the Member will primarily or exclusively provide proprietary products to the client; or whether there are other restrictions on the selection of products or services.

Disclosure should briefly describe each category of registration under securities legislation in which the Member is licensed (e.g. exempt market dealer, mutual fund dealer), and the investment products in which the Member may transact (i.e. is permitted to / not prohibited from transacting in) as a result of such license(s).

A Member may also be restricted by terms and conditions placed on its registration, as well as by business decisions to limit what it offers to clients based on account type or other considerations. The products or services that the Member offers to a client might also be restricted as a result of regulatory or business restrictions on an Approved Person assigned to their account.

Disclosure must include any restrictions on a client's ability to liquidate or resell an investment product (e.g. as is the case with certain proprietary products, exempt securities, or securities of a hedge fund).

Where the Member sells investment products pursuant to an exclusive distribution arrangement that restricts clients from in-kind transfers of assets to another dealer (i.e. where client investments would have to be liquidated in the event of such a transfer), this must be explained to the client and noted in relationship disclosure information provided by the Member to clients. Where Members sell proprietary products or mutual funds of a related issuer, this must also be disclosed.

A Member's duty to deal with the client fairly, honestly and in good faith, and its obligation to make suitability determinations that put the client's interests first, require the Member to tell a client if it does not have products or services that are suitable for them. This determination may depend on the investment goals designated for the client's account. For example, it may make a difference if the account is the primary retirement savings vehicle for a retail investor, or is a secondary account set up by an accredited investor for speculating in exempt market products.

- Procedures Regarding Handling of Cash and Cheques

Disclosure of the Member's procedures regarding the receipt and handling of client cash and cheques must be provided to the client. This disclosure requirement is intended to assist clients in understanding which parties are responsible for handling their cash and to whom they should be making cheques payable. In the case of a Level 2 dealer, the disclosure must include an

explanation that all client cheques shall be payable to the issuer or carrying dealer, as applicable.

Members should consider including disclosure to clients that all cheques must be made payable to the Member only and not to the Approved Person. Where Members do not allow their Approved Persons to accept cash for the purchase of securities, this should also be disclosed to the client.

- Requirement for Investment Actions to be Suitable and put the Client's Interest First

Rule 2.2.7(1)(~~fe~~) requires a statement that the Member must determine that any investment action it takes, recommends or decides on for the client is suitable and puts the client's interest first. This will include a statement that Members are required under securities legislation and MFDA Rules to ensure each recommendation made is suitable for the client, and puts the client's interest first. Clients should also be advised that the obligation to make a suitability determination applies to trades proposed by the client, whether or not a recommendation is made.

Members are also required to include in their relationship disclosure a description of the following events, which trigger a suitability determination:

- When the client transfers assets into an account at the Member;
  - The Member or Approved Person becomes aware of a change in an investment in the client's account that could result in the investment or account not satisfying requirements under Rule 2.2.6(1);
  - When the Member or Approved Persons becomes aware of a material change, as defined under Rule 2.2.4, in the client information required to be collected under Rule 2.2.1, that could result in an investment or the client's account not satisfying requirements under Rule 2.2.6(1);
  - The Member or Approved Person performs the periodic review required under Rule 2.2.4(f); or
  - When there is a change in the Approved Person responsible for the client's account at the Member.
- Defining KYC Terms

It is essential that clients understand the basis upon which their investments are assessed. Accordingly, KYC information must be defined in a clear and concise way to assist clients in understanding what the KYC terms mean and how the criteria will relate to the specific investments recommended or accepted by the Member.

The requirements of this section do not contemplate defining all KYC terms, as MFDA staff acknowledges that certain terms, such as age or income, are self-explanatory. However, "risk profile", "investment time horizon", and "investment needs and objectives" are examples of key terms that should be defined, since Members and their clients do not always have the same understanding of these terms.

As a best practice, the definition of KYC terms should be incorporated into the New Account Application Form ("NAAF") to ensure that clients are aware of and acknowledge the basis on

which the Member and Approved Person will assess the suitability of investments for their account.

- Content and Frequency of Reporting

A description of the content and frequency of reporting for each account must be included in the document. Members must inform the client when trade confirmations and account statements will be sent and describe the performance reporting information that will be provided by the Member under Rule 5.3.5.

- Compensation and Reference to Other Sources of Information

Disclosure must include a general description of the nature of compensation paid to the Member with a reference to more specific information available through other sources. For example, this may include a statement that the Member receives a commission at the time of the sale of an investment and may earn an ongoing commission (trailer fees) for as long as the client holds the investment. In order to help their clients to understand what trailing commissions and fund management fees are, we encourage Members and Approved Persons to explain them in the simplest terms possible. This should include explaining that trailing commissions are not additional charges paid by the client to the Member. Clients should also be made aware that there may be other fees or costs charged by the product manufacturer depending on the investment product. This general information with respect to how the Member is compensated and the possibility of other costs associated with making and holding investments is intended to supplement more specific product disclosure with respect to fees and costs available through the prospectus or offering memorandum.

Members may also wish to advise clients that they can speak to their Approved Person for more information about the nature of any fees or compensation paid to the Member.

### **Approval of Relationship Disclosure Materials**

Where standardized relationship disclosure is provided to all clients, it must be approved by compliance staff at the Member's head office. If the relationship disclosure is customized for each client or classes of clients, the Member should have a procedure in place that requires the approval of a supervisor at the head office and/or branch level.

### **Maintaining Evidence of Relationship Disclosure**

Members must maintain evidence that the required relationship disclosure has been provided to clients. If the relationship disclosure is incorporated into the NAAF or account documentation and is signed by the client, maintaining a copy in the client file will be sufficient to evidence delivery.

Members that choose to provide the relationship disclosure as a stand-alone document may evidence delivery by signed client acknowledgements or by maintaining copies of disclosure documents in client files, along with detailed notes of client meetings and discussions evidencing that the disclosure has been provided. Members are advised to reference MFDA Member

Regulation Notice MR-0064 *Maintaining Evidence of Disclosure* for more guidance with respect to maintaining evidence of required disclosures.

### **Significant Changes**

As with other disclosure requirements under MFDA Rules, where there is a significant change to information previously provided to the client, it is expected that the Member will take reasonable steps to notify the client of the changes in a timely manner. Members may advise the client of the change by including updated information with regular client communications such as account statements. A significant change would include, for example, a change in definitions of KYC terms.

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