

## **Mutual Fund Dealers Association of Canada**

### **Proposed Amendments to MFDA Rule 5.3 (Client Reporting) and MFDA Rule 2.8 (Client Communications)**

#### **I. OVERVIEW**

##### **A. Current Rules**

MFDA Rule 2.8.3 requires that where a client communication refers to a rate of return, the client must be advised as to the methodology employed in calculating the rate of return noted in the communication.

MFDA Rule 5.3 prescribes the minimum reporting requirements that Members must provide on client accounts. The Rule prescribes standards with respect to frequency for delivery and content of client statements.

##### **B. The Issues**

Since September 2004, staff of the MFDA, the Investment Dealers Association of Canada (“IDA”) and the Canadian Securities Administrators (“CSA”) have been working together to implement various aspects of the Client Relationship Model (“CRM”) project. One of the principles CRM seeks to address is the gap in current regulatory requirements with respect to mandatory periodic reporting of account performance to clients. While some Members do provide performance reporting to clients, such reports are not currently required under MFDA Rules and Policies.

In addition, in the course of completing compliance reviews, the MFDA has noted inconsistencies and potentially misleading information in performance reports provided to clients directly by some Approved Persons. Some Members have adopted policies and procedures whereby the Member does not properly supervise performance reports generated by Approved Persons, but simply disclaims responsibility for the content of these reports. The MFDA is of the view that such policies are inconsistent with business conduct requirements under MFDA By-laws, Rules and Policies.

##### **C. Objectives**

The objective of the proposed amendments is to ensure that all clients are provided with a minimum level of information with respect to the performance of the investments in their accounts. The proposed amendments have been drafted to establish minimum standards, but also to allow for a degree of flexibility in meeting this basic objective.

The proposed amendments to Rule 2.8 are intended to clarify the supervisory obligations of Members in relation to performance reporting provided directly to clients by Approved Persons.

#### **D. Effect of Proposed Amendments**

The proposed amendments will require Members to provide annual reports to all clients that show either the holdings in the account and funds invested and withdrawn from the account or provide annualized percentage rates of returns on investments in the account. The proposed amendments will require changes to the reporting currently provided for client name accounts.

Other minor changes have been proposed with respect to Rule 5.3.1(a), 5.3.1(c) and 5.3.3(c) to clarify existing requirements or to address inconsistencies with other provisions.

Rule 2.8.3 will be amended to clarify the Member's supervisory requirements regarding client communications that disclose a rate of return. Members that allow Approved Persons to provide such information to clients may be required to make changes to existing supervisory procedures.

It is not expected that the proposed amendments will have other significant effects on Members, other market participants, market structure or competition. Compliance with the additional reporting requirements may result in additional costs for Members.

## **II. DETAILED ANALYSIS**

### **A. Relevant History**

In February, 2000, the Ontario Securities Commission ("OSC") established the Fair Dealing Model Committee. The findings of this committee were summarized in the OSC's Fair Dealing Model Concept Paper which was published in January, 2004. The Fair Dealing Model Concept Paper also set forth a number of proposals for regulatory reform, touching on many aspects of the client/advisor relationship.

Certain issues raised in the Fair Dealing Model Concept Paper were carried forward under the CRM project, which, as noted above, involved staff of the MFDA, IDA and the CSA. The three core principles that the CRM project seeks to address are:

- clarity of the client/firm relationship;
- performance reporting; and
- cost, compensation and conflicts disclosure.

MFDA staff has conducted numerous consultations on various proposals to address the CRM project's objectives. These were conducted through the MFDA Member Regulation Forums, the MFDA Policy Advisory Committee and other ad hoc industry meetings and involved Members, other regulators and other industry participants. In the course of these consultations, many suggestions were brought forward and discussed with industry participants. The input received by staff has been factored into the proposed amendments that are now being published for comment.

The possibility of conducting a cost/benefit analysis of changes proposed in relation to the CRM project was also discussed. However, no agreement with potential participants was reached regarding the approach to be followed in conducting the analysis. Many of the proposed amendments, however, were developed in part to address regulatory concerns identified in the course of the MFDA's regular compliance and enforcement activities. Further, the proposed amendments have been developed with the intent of achieving the investor protection objectives of the CRM project while taking into account existing operational systems.

While there is some degree of overlap between each of the CRM issues, the core principles were to a large extent considered discreetly. For the purpose of clarity, the resulting proposed changes to the Rules and Policies that relate to each issue are being published for comment separately as well.

The MFDA has also received comments from Members requesting clarification of other issues regarding Rule 5. As these issues relate to similar concerns raised under the CRM project and involve the same Rules and Policies, proposed changes to address these additional issues are being brought forward with the amendments relating to the CRM project.

#### **B. Proposed Amendments**

Proposed amendments to Rule 5.3 will require that all clients be provided with account performance reporting on an annual basis covering at least a 12 month period. The proposed amendments provide that Members may satisfy this requirement by either providing:

- the total market value of the account as at the start of the period covered by the report;
- assets deposited/withdrawn during the period of the report;
- the total market value of the account as at the end of the period covered by the report.

or annualized percentage rate of return information presented in accordance with the requirements of Rule 2.8.3.

Other minor additional amendments have been made to clarify the current language and intent of Rule 5.3 in response to comments from Members.

The proposed amendments to Rule 5.3 are noted in Schedule "A" to this notice.

Rule 2.8.3 will be amended to clarify that where a client communication discloses a rate of return, the rate of return must be calculated in accordance with standard industry

practices. Further, the amendments clarify the Member's supervisory obligations where such communications are issued by an Approved Person.

The proposed amendments to Rule 2.8 are noted in Schedule "B" to this notice.

### **C. Issues and Alternatives Considered**

A number of alternative approaches to addressing the issue of performance reporting to clients were considered in developing the proposed amendments.

Consideration was given to mandating rates of return and prescribing the method to be used in calculating returns. The proposed amendments do not require that returns be reported, but do impose requirements where the Member or its Approved Persons opt to provide such information to clients. Members that choose to provide rates of return will be required to calculate returns in accordance with standard industry practices and the Member will be required to disclose the method used.

The objective of the CRM project is to develop basic fundamental regulatory requirements to ensure that clients receive core information on account performance. The proposed amendments have been drafted to provide some flexibility as to how this objective can be satisfied. Some Members currently provide performance information to clients, but may do so in different ways (ie. reporting on an annual or cumulative basis or reporting percentage rates of return). The proposed amendments set out the core objective for Members to provide information to clients on an annual basis with respect to account performance and set out minimum standards as to how this objective can be achieved. The MFDA recognizes that Members may adopt alternative measures that meet or exceed the minimum standards in the Rule. MFDA staff will be issuing a Member Regulation Notice to provide more guidance as to how the requirements under the proposed amendments may be satisfied.

As the proposed amendments will require Members to report client name holdings, the issue of disclosure regarding MFDA Investor Protection Corporation ("IPC") coverage was also considered in developing the proposed amendments. Issues have been noted in the past regarding the disclosure of investor protection plan coverage where securities are held in client name and, historically, this has not been allowed. However, the MFDA has been advised that the MFDA IPC will be reviewing the issue with a view to working with the MFDA to develop guidelines to be followed in providing such disclosure to clients.

### **D. Comparison with Similar Provisions**

The Financial Services Authority (the "FSA") in the United Kingdom currently requires registered firms to provide all clients with a periodic report containing certain prescribed information. The report must be provided every six months, or every three months if the client so requests (New Conduct of Business Sourcebook – Section 16.3). The information to be provided includes market value of each security (or fair value if market value is not available), fees, portfolio performance and a comparison with the performance benchmark (if any) agreed to between the firm and the client.



**E. Systems Impact of Amendments**

Some Members currently provide some or all of the required information with respect to the proposed changes to the client reporting requirements and it is not anticipated that there will be a significant system impact on those Members as a result of the proposed amendments. The system impact will be greater for Members that do not presently have the ability to provide any of the required information to clients.

As system changes will be required for some Members, the MFDA will consider transition periods for the implementation of the amendments to Rule 5.3.5 to allow Members sufficient time to comply with the new requirements. **Comments and suggestions regarding reasonable transition periods would assist in this regard.**

**F. Best Interests of the Capital Markets**

The Board has determined that the proposed amendments are in the best interests of the capital markets.

**G. Public Interest Objective**

The proposed amendments will assist in the protection of investors by ensuring that all investors receive basic information as to the performance of securities in their accounts. The proposed amendments will also address issues identified with respect to the accuracy and reliability of performance information currently provided directly to clients by Approved Persons.

**III. COMMENTARY**

**A. Filing in Other Jurisdictions**

The proposed amendments will be filed for approval with the Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

**B. Effectiveness**

The proposed amendments are simple and effective.

**C. Process**

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on May 22, 2008.

**D. Effective Date**

The proposed amendments will be effective on a date to be subsequently determined by the MFDA.

#### IV. SOURCES

MFDA Rule 2.8

MFDA Rule 5

FSA - New Conduct of Business Sourcebook – Section 16.3

#### V. REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

**The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets.**

**Comments are sought on the proposed amendments.** 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 the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Sarah Corrigan-Brown, Senior Legal Counsel, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at [www.mfda.ca](http://www.mfda.ca).

Questions may be referred to:

Paige Ward  
Director of Policy and Regulatory Affairs  
Mutual Fund Dealers Association of Canada  
(416) 943-5838

## **Schedule A**

### **Mutual Fund Dealers Association of Canada**

#### **Client Reporting (Rule 5.3)**

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 5.3:

#### **5.3 CLIENT REPORTING**

##### **5.3.1 Delivery of Account Statement**

- (a) Each Member shall, in a timely manner send an account statement to each client in accordance with the following minimum standards:
  - (i) once every 12 months for a client name account;
  - (ii) once a month for nominee name accounts of clients where there is an entry during the month and a cash balance or security position; and
  - (iii) quarterly for nominee name accounts where no entry has occurred in the account and there is a cash balance or security position at the end of the quarter.
- (b) A Member may not rely on any other person (including an Approved Person) to send account statements as required by this Rule.
- (c) Notwithstanding the provisions of 5.3.1(b), a Member may rely on the trustee administering a self-directed registered plan to send the account statement required by paragraph (a)(i) where the following conditions are met:
  - (i) The Member does not act as agent for the trustee for the registered plans;
  - (ii) The trustee meets the definition of “Acceptable Institution” as defined in Form 1;
  - (iii) There is a services agreement in place between the Member and the trustee which complies with the requirements of MFDA Rule 1.1.3 and provides that the trustee is responsible for sending account statements to clients of the Member that comply with the requirements of MFDA Rule 5;
  - (iv) There is clear disclosure about which trades are placed by the Member;
  - (v) Clear disclosure must be provided on the account statement regarding which securities positions referred to on the statement are

eligible for coverage by the MFDA Investor Protection Corporation and which are not (once the Corporation is offering coverage);

- (vi) The Member's full legal name must appear on the account statement together with the name of the trustee; and
  - (vii) The Member must receive copies of the statements, or have other systems in place, to ensure that the information contained ~~therein~~ on the statements matches its own information regarding the transactions it executes.
- (d) Notwithstanding the provisions of Rule 5.3.1(b), where a Member is affiliated with a fund manager and in connection with a specific client account is selling only the mutual fund securities of an issuer managed by such affiliated fund manager for that client account, the Member may rely on the affiliated fund manager to send the account statement required by paragraph (a)(i) for that specific account.

**5.3.2 Automatic Payment Plans.** Notwithstanding the provisions of Rule 5.3.1(a)(ii), where a Member holds client assets in nominee name and the only entry in the client's account in a month relates to the client's participation in:

- (a) any automatic payment plan that provides for systematic trading in the securities of a mutual fund on a monthly or more frequent basis, or
  - (b) other automatic entries such as dividends and reinvested distributions,
- the Member shall send an account statement to the client quarterly.

**5.3.3 Content of Account Statement.** Each account statement must contain the following information:

- (a) for nominee name accounts or accounts where the Member acts as an agent for the trustee for the purposes of administering a self-directed registered retirement savings or similar plan:
  - (i) the opening balance;
  - (ii) all debits and credits;
  - (iii) the closing balance;
  - (iv) the quantity and description of each security purchased, sold or transferred and the dates of each transaction, and;
  - (v) the quantity, description and market value of each security position held for the account;
- (b) for client name accounts:
  - (i) all debits and credits;

- (ii) the quantity and description of each security purchased, sold or transferred and the dates of each transaction; and
  - (iii) for automatic payment plan transactions, the date the plan was initiated, a description of the security and the initial payment amount made under the plan.
- (c) for all accounts:
- (i) the type of account;
  - (ii) the account number;
  - ~~(iii) the date the statement was issued;~~
  - ~~(iv)~~(iii) the period covered by the statement;
  - ~~(v)~~(iv) the name of the Approved Person(s) servicing the account, if applicable; and
  - ~~(vi)~~(v) the name, address and telephone number of the Member.

5.3.4 **Member Business Only.** Only transactions executed by the Member may appear on the statement of account required pursuant to Rule 5.3.3.

5.3.5 **Account Performance Reporting.** The Member must provide information to clients on an annual basis with respect to the performance of the client's account at the Member.

- (a) Subject to paragraphs (b) and (c), the account performance reporting must include the following information for the annual period:
- i) the total market value of the account as at the start of the period covered by the report;
  - ii) total assets deposited to the account during the period covered by the report;
  - iii) total assets withdrawn from the account during the period covered by the report;
  - iv) the total market value of the account as at the end of the period covered by the report.
- (b) Notwithstanding the provisions of paragraph (a), where market values cannot be readily and reliably determined by the Member in respect of security positions held in the account, such values shall not be included in the report and the Member must disclose to the client in the report the security positions for which values have not been included and why the information has not been included in the report.
- (c) A Member need not send the information contained in paragraph (a) where the Member sends a client communication that contains an annualized percentage rate of return for the client's account in accordance with the requirements of Rule 2.8.3.

## Schedule B

### **Mutual Fund Dealers Association of Canada**

#### **Client Communications (Rule 2.8)**

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 2.8:

#### **2.8.3 Rates of Return**

- (a) In addition to complying with the requirements in Rule 2.8.2, any client communication containing or referring to a rate of return regarding a specific account or group of accounts must: ~~be based on~~
- (i) disclose an annualized rate of return calculated in accordance with standard industry practices; and
  - (ii) explain the methodology used to calculate such rate of return in sufficient detail and clarity to reasonably permit the client to understand the basis for the rate of return.
- (b) In addition to complying with the requirements in Rule 2.8.2 and Rule 2.8.3(a), any client communication containing or referring to a rate of return regarding a specific account or group of accounts that is provided by an Approved Person must be approved and supervised by the Member.
- (b)(c) Notwithstanding the provisions of paragraphs (a) and (b), where an account has been open for less than 12 months, the rate of return shown must be the total rate of return since account opening.