

THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

HOUSEKEEPING AMENDMENTS TO MFDA RULE 5.3 (CLIENT REPORTING) AND MFDA POLICY NO. 7 (PERFORMANCE REPORTING)

Background

On March 28, 2013, the Canadian Securities Administrators (“CSA”) published Client Relationship Model Phase 2 (“CRM2”) amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”) and the Companion Policy to the Instrument. The CRM2 amendments introduce requirements under NI 31-103 in the areas of client statements, charges and compensation disclosure and performance reporting. These amendments came into force on July 15, 2013. Client statement requirements under NI 31-103 are effective on July 15, 2015. Requirements in respect of charges and compensation disclosure and performance reporting are effective on July 15, 2016. Conforming amendments with the same effective dates were made to MFDA Rules to adopt requirements established under the CRM2 amendments to NI 31-103.

CSA Relief Orders

Some registered firms indicated they might experience difficulty implementing certain CRM2 requirements by the effective dates. Further, technical issues were identified relating to the delivery of information prescribed by the CRM2 requirements. These concerns, along with a request for related relief, were formally raised by industry stakeholders in a letter to the CSA. In response, the CSA in a letter dated January 28, 2015, announced decisions to provide conditional exemptive relief from certain CRM2 requirements under NI 31-103.

To give effect to the relief addressed in their January 28, 2015 letter, along with other relief, the CSA issued Relief Orders on May 21, 2015. The terms of the CSA Relief Orders provide non-SRO registrants under securities legislation with more time to address implementation and technical issues.

MFDA Rules are required to be consistent with similar requirements under securities legislation. Accordingly, the proposed housekeeping amendments and a proposed extension of the transition period applicable to certain CRM2 requirements are being brought forward at this time to ensure that MFDA Members are provided with the same relief granted to non-SRO registrants under the CSA Relief Orders.

Attached as Schedule “A” are proposed housekeeping amendments to MFDA Rule 5.3 and Policy No. 7. The current versions of the Rule and Policy have been blacklined to show changes introduced by the proposed amendments.

Extension of Transition Period

Certain requirements under the CRM2 amendments to NI 31-103 apply to account statements (i.e. statement content and related matters). These requirements come into effect on July 15, 2015. Under the CSA Relief Orders, more time is being provided to non-SRO registrants to implement these requirements. Specifically, new requirements pertaining to account statements may be met by

delivering statements for the period ending December 31, 2015 (i.e. including transactions from October – December, 2015), instead of the period that includes July 15, 2015.

On June 4, 2015, the MFDA Board of Directors provided an extension in respect of the transition period applicable to new requirements pertaining to account statements, as set out under MFDA Rule 5.3 (Client Reporting). The purpose of this extension is to adopt the December 31, 2015 date in relation to such requirements, harmonize with the relief provided to non-SRO registrants under the CSA Relief Orders and, thereby, ensure that such relief is also available to MFDA Members.

Nature of the Amendments

The proposed amendments to Rule 5.3(1) and Policy No. 7, as summarized below, are housekeeping in nature. In adopting this classification for the proposed amendments, the MFDA has relied upon section 3(b)(vi) of the Joint Rule Review Protocol for the MFDA, which provides, in relevant part, that housekeeping Rule changes include those that are reasonably necessary to conform MFDA Rules to applicable securities legislation, statutory or legal requirements.

Definitions - Rule 5.3(1)

Under the proposed amendments to Rule 5.3(1)(c)(i) and (ii), date changes and other minor changes would be made in respect of requirements that address the determination of cost for each investment position in the account. The CSA Relief Orders include a definition of “similar clients”. This definition has been directly adopted under proposed new Rule 5.3(1)(j).

Performance Reporting – Policy No.7

Requirements in respect of performance reporting come into effect on July 15, 2016. The CSA Relief Orders provide performance reporting relief to non-SRO registrants in respect of requirements related to the provision of market value and annualized total percentage return information. Specifically, non-SRO registrants reporting on a calendar year basis in 2016, will not be required to include comparative data from 2015 (i.e. the first performance report may be based on 2016 data alone). The relevant terms of this relief have been directly adopted under a new section to MFDA Policy No.7.

Process

The MFDA followed its established internal governance practices in approving the proposed amendments and considered the need for consequential amendments. On June 4, 2015, the MFDA Board of Directors approved the proposed amendments. The Board has determined that the proposed amendments are in the public interest.

Conflict with Applicable Laws or Terms and Conditions of Recognition Order

The proposed amendments do not conflict with applicable laws or the Terms and Conditions of a Recognizing Regulator’s Recognition Order.

Effective Date

The proposed amendments to Rule 5.3 and Policy No. 7 will become effective on a date to be subsequently determined by the MFDA.

SCHEDULE A

5.3 CLIENT REPORTING

- (1) **Definitions.** For the purpose of client reporting requirements under Rule 5.3
- (a) “book cost” means the total amount paid to purchase an investment, including any transaction charges related to the purchase, adjusted for reinvested distributions, returns of capital and corporate reorganizations;
 - (b) “connected issuer” has the same meaning as in section 1.1 of National Instrument 33-105 *Underwriting Conflicts*;
 - (c) “cost” for each investment position in the account means either “book cost” or “original cost”, provided that only one cost calculation methodology, either “book cost” or “original cost,” is used for all positions;
 - (i) **Investment Positions Opened before December 31~~July 15~~, 2015.** For investment positions opened before December 31~~July 15~~, 2015, cost, as determined in accordance with subsection 5.3(1)(c), above; or the market value of the investment position as at December 31~~July 15~~, 2015 or an earlier date, if the same date and value are used for all similar-clients of the Member ~~holding that investment~~ and it is also disclosed in the account statement that it is the market value as of that date, not the cost of the investment position, that is being disclosed.
 - (ii) **Investment Positions Transferred In.** For investment positions transferred into an account at the Member, cost as determined in accordance with subsection 5.3(1)(c), above; or the market value of the investment position as at the date of the position’s transfer if it is also disclosed in the account statement that it is the market value ~~as of the transfer date~~, not the cost of the investment position, that is being disclosed.
 - (iii) **Where Cost Not Determinable.** Where a Member reasonably believes that it cannot determine cost in respect of an investment position, the Member must provide disclosure of that fact in the statement.
 - (d) “investment” means any asset, excluding cash, held or transacted in an account of the Member;
 - (e) “marketplace” has the same meaning as in section 1.1 of National Instrument 21-101 *Marketplace Operation*;
 - (f) “market value” of a security has the meaning given to it under MFDA Form 1 *Financial Questionnaire and Report*;
 - (g) “operating charge” means any amount charged to a client by a Member in respect of the operation, transfer or termination of a client’s account and includes any federal, provincial or territorial sales taxes paid on that amount;

- (h) “original cost” means the total amount paid to purchase an investment, including any transaction charges related to the purchase;
- (i) “related issuer” has the same meaning as in section 1.1 of National Instrument 33-105 *Underwriting Conflicts*;
- ~~(j)~~(j) “similar clients” means any of the following: (i) clients whose accounts or investment positions were transferred together to a Member; (ii) clients whose accounts or investment positions are on the same reporting system, if a Member has more than one reporting system; or (iii) other clients whose accounts or investment positions would appear to a reasonable person to be similar in a way that relates to the recording or calculation of market value or position cost;
- ~~(k)~~(k) “total percentage return” means the cumulative realized and unrealized capital gains and losses of an investment, plus income from the investment, over a specified period of time, expressed as a percentage;
- ~~(l)~~(l) “trailing commission” means any payment related to a client’s ownership of a security that is part of a continuing series of payments to a Member or Approved Person by any party;
- ~~(m)~~(m) “transaction charge” means any amount charged to a client by a Member and includes any federal, provincial or territorial sales taxes paid on that amount.

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MFDA POLICY NO. 7

PERFORMANCE REPORTING

Purpose

Under Rule 5.3.4 (Performance Report), Members are required to deliver a performance report to a client. The purpose of this Policy is to set out additional requirements that Members must comply with when meeting requirements under MFDA Rules respecting the performance report.

General Requirements

- (1) The performance report required under Rule 5.3.4 must be delivered in a separate report for each account of the client;
- (2) Notwithstanding subsection (1), a Member may provide a performance report that consolidates, into a single report, the required information for more than one of a client's accounts if:
 - (a) the client has consented in writing; and
 - (b) the consolidated report specifies which accounts it consolidates.
- (3) Where a consolidated performance report is sent to a client, pursuant to subsection (2), above and a consolidated report on charges and other compensation is sent to the client pursuant to Rule 5.3.3(3), both consolidated reports must consolidate information for the same accounts.
- (4) The requirement to provide a performance report, as prescribed under Rule 5.3.4, does not apply to a client account that has existed for less than a 12-month period.
- (5) If a Member reasonably believes there are no investments of a client for which a market value can be determined, the Member is not required to deliver a report to the client for the period.

Content of Performance Report

- (1) A performance report required to be delivered under Rule 5.3.4 must include all of the following in respect of investments reported on the account statement required to be delivered under Rule 5.3.1:
 - (a) the market value of all cash and investments in the client's account as at the beginning of the 12-month period covered by the report;

- (b) the market value of all cash and investments in the client's account as at the end of the 12-month period covered by the report;
- (c) the market value of all deposits and transfers of cash and investments into the client's account, and the market value of all withdrawals and transfers of cash and investments out of the account, in the 12-month period covered by the report;
- (d) subject to paragraph 1(e), the market value of all deposits and transfers of cash and investments into the client's account, and the market value of all withdrawals and transfers of cash and investments out of the account, since opening the account;
- (e) if the client's account was opened before July 15, 2015 ~~and the Member reasonably believes market values are not available for all deposits, withdrawals and transfers since the account was opened,~~ the following:
 - (i) the market value of all cash and investments in the client's account as at July 15, 2015;
 - (ii) the market value of all deposits and transfers of cash and investments into the account and the market value of all withdrawals and transfers of cash and investments out of the account, since July 15, 2015;
 - (iii) notwithstanding the provisions of (1)(e)(i) and (ii) above, an earlier date may be used to comply with requirements under (1)(e), if the same date and value are used for all similar clients of the Member ~~holding that investment and it is also disclosed in the performance report that it is the market value as of that date, not the cost of the security position, that is being disclosed.~~

Annual Change in Market Value

- (f) the annual change in the market value of the client's account for the 12-month period covered by the performance report, determined using the following formula:

$$A - B - C + D$$

where

- A** = the market value of all cash and investments in the account as at the end of the 12-month period covered by the performance report;
- B** = the market value of all cash and investments in the account at the beginning of that 12-month period;
- C** = the market value of all deposits and transfers of cash and investments into the account in that 12-month period; and
- D** = the market value of all withdrawals and transfers of cash and investments out of the account in that 12-month period.

Cumulative Change in Market Value

- (g) subject to paragraph (h), the cumulative change in the market value of the account since the account was opened, determined using the following formula:

$$\mathbf{A - E + F}$$

where

- A** = the market value of all cash and investments in the account as at the end of the 12-month period covered by the performance report;
- E** = the market value of all deposits and transfers of cash and investments into the account since account opening; and
- F** = the market value of all withdrawals and transfers of cash and investments out of the account since account opening.

- (h) if ~~the Member reasonably believes~~ the market value of all deposits and transfers of cash and investments into the account since the account was opened or the market value of all withdrawals and transfers of cash and investments out of the account since the account was opened, as required in paragraph (g), is not available to the Member, the cumulative change in the market value of the account determined using the following formula:

$$\mathbf{A - G - H + I}$$

where

- A** = the market value of all cash and investments in the account as at the end of the 12-month period covered by the performance report;
- G** = the market value of all cash and investments in the account as at July 15, 2015 or an earlier date used for all similar clients;
- H** = the market value of all deposits and transfers of cash and investments into the account since the date used for G; and
- I** = the market value of all withdrawals and transfers of cash and investments out of the account since the date used for G.

Annualized Total Percentage Return

- (i) the amount of the annualized total percentage return for the client's account calculated net of charges, using a money-weighted rate of return calculation method generally accepted in the securities industry;

- (j) the definition of “total percentage return” set out under Rule 5.3(1) and a notification indicating the following:
 - (i) that the total percentage return in the performance report was calculated net of charges;
 - (ii) the calculation method used; and
 - (iii) a general explanation in plain language of what the calculation method takes into account.

Annualized Total Percentage Return – Reporting Periods

(2) The information delivered for the purposes of paragraph (1)(i) must be provided for each of the following periods:

- (a) the 12-month period covered by the performance report;
- (b) the 3-year period preceding the end of the 12-month period covered by the report;
- (c) the 5-year period preceding the end of the 12-month period covered by the report;
- (d) the 10-year period preceding the end of the 12-month period covered by the report;
- (e) the period since the client’s account was opened if the account has been open for more than one year before the date of the report or, if the account was opened before July 15, 2015 ~~and the Member reasonably believes the annualized total percentage return for the period before July 15, 2015 is not available~~, the period since July 15, 2015 or an earlier date used for all similar clients.

(3) Despite subsection (2), if any portion of a period referred to in paragraphs (2)(b), (c) or (d) was before July 15, 2015, the Member is not required to report the annualized total percentage return for that period.

Presentation

(4) The information required to be delivered under Rule 5.3.4 must be presented using text, tables and charts and must be accompanied by notes in the performance report explaining:

- (a) the content of the report and how a client can use the information to assess the performance of the client’s investments; and
- (b) the changing value of the client’s investments as reflected in the information in the report.

(5) If a Member delivers information required under Rule 5.3.4 in a report to a client for a period of less than one year, the Member must not calculate the disclosed information on an annualized basis.

- (6) If a Member reasonably believes the market value cannot be determined for an investment position, the market value must be assigned a value of zero in the calculation of the information required to be delivered under Rule 5.3.4 and the fact that its market value could not be determined must be disclosed to the client.

Exemptions Respecting First Performance Report

Notwithstanding the requirements noted above, the following exemptions apply in respect of the first performance report sent by Members to their clients:

Content of Performance Report

- (1) A Member is exempt from the requirements under paragraphs 1(e) and (h), respecting the provision of market value information as at and since July 15, 2015 if instead a performance report is delivered that provides the information for the 12 month period ending December 31, 2016 and the included market value information is as at and since:
- (a) January 1, 2016; or
 - (b) a date earlier than January 1, 2016, if the same date is used for all similar clients.

Annualized Total Percentage Return – Reporting Periods

- (2) A Member is exempt from the requirement under paragraph 2(e), respecting the provision of annualized total percentage return information, if, instead, an investment performance report is delivered that provides the information for the 12 month period ending December 31, 2016.

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