



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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- And -

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**RE: Proposals to implement the core principles of the Client Relationship Model**

Dear Sirs and Madames:

The Investment Industry Association of Canada (IIAC) is writing on behalf of our membership to respond to the request for comments from the Investment Industry Regulatory Organization of Canada (IIROC) on the proposals to implement the core principles of the Client Relationship Model (proposed CRM Rules).

This comment letter has been drafted with the assistance of the IIAC CRM Committee, which consists of numerous members from across Canada, representing a broad cross-

section of firms. The industry professionals on this Committee are knowledgeable and experienced in the wealth management business, and many of them have been involved for numerous years in this rule-making exercise.

The IIAC Committee has commented extensively on earlier versions of the CRM in detailed submissions to IIROC in November 2006, April 2007, January 2008, May 2008 and July 2009.

We understand that IIROC staff has further developed and revised the proposed CRM Rules based on comments received. However, although the IIAC acknowledges that certain changes have previously been made to provide some flexibility and to respond to consistency issues as among the Canadian Securities Administrators (CSA) and the Mutual Fund Dealers Association (MFDA) proposed CRM Rules, we believe that there are still deficiencies remaining.

As the IIAC has stated in the past, the members of our Committee support the core principles under CRM but continue to believe that further improvements can and need to be made to the proposed CRM Rules to address some of the outstanding fundamental issues raised in previous IIAC submission and in particular in the areas of the suitability, conflicts of interest and performance reporting requirements.

#### **Account Suitability – Amendments to Rule 1300.1**

Proposed Rule 1300.1 will require additional factors to be considered during a suitability review beyond the current factors of financial situation, investment knowledge, investment objectives and risk tolerance. The proposed Rule will require a consideration of time horizon and the account's current investment portfolio composition and risk level.

This is a significant change, requiring updating systems and recordkeeping in order to reference these new suitability factors. The proposed six month transition period is not sufficient to make these changes, given the technology overhaul that will be necessary. Further to this point, it is in fact not clear that a "transition period" applies to the amendments contemplated in Rule 1300.1. When are firms expected to start complying with Rule 1300.1?

Finally, the proposed Rule relating to the content of the RDD has not been updated in Section XX05(2)(i) to reflect that firms are now required to consider a client's time horizon and the account's current investment portfolio composition and risk level when providing a client with a description of how investment suitability is assessed.

In addition, it appears that there is a typo in 1300.1(p) as the reference to 1300.1(s) should read 130.1(u).

#### **Rule 1300.1 (p) and (r) and "ensure"**

The CRM Committee appreciates that IIROC has stated in its response to comments that it agrees that a Dealer Member cannot "ensure" that positions transferred are suitable for the client, and indicated that there have been revisions to the proposed Rule. However, it

is not apparent in the proposed Rule or draft CRM Guidance Note that any changes have been made from the previous versions.

Consequently, the language in the proposed Rule would still technically require ensuring that positions transferred in are suitable. The IAC therefore requests additional clarification.

We further suggest that Rule 1300.1(p), which pertains to orders accepted from the client (without a recommendation), be amended to remove the word “ensure” and replace it to read that the Dealer Member shall use due diligence “in considering” that the acceptance of any order is acceptable.

### Time Horizon

We recognize that time horizon has been included as a factor in proposed Rule 1300.1(p), however, it appears that the draft Guidance Note, Know your client and suitability (KYC Guidance Note) has not been amended to reflect this change.

### Trigger Events

As outlined in previous comment letters, the proposed CRM Rules introduce the concept of suitability reviews based on prescribed triggers. Currently, Rule 1300.1(p) requires that a member use due diligence to ensure that the acceptance of any order from a client is suitable. The proposed Rules would not only require a suitability review when a transaction occurs but also when one of the trigger events occurs.

However, as the IAC has previously pointed out, our members believe this is a significant change to the current suitability requirements and, as such, will result in substantial modification to the operations of member firms. For example, in order to ensure that a suitability review is conducted when one of the triggers occur, members will need to have systems designed to monitor these triggers and ensure the suitability review took place and was documented in some fashion. The operational and tracking systems that would be required will be a considerable cost for firms. As a result, the IAC continues to suggest that the trigger suitability requirements be implemented as a best practice recommendation rather than a strict regulatory requirement.

With respect to the specific trigger events in proposed Rule 1300.1(r)(i) related to deposits or transfers in the account, systems are not usually programmed to provide this type of information. As a result, the individual advisor is not automatically notified of such transfers or deposits and therefore is only made aware of the transfer or deposit when the trade occurs.

Moreover, proposed Rule 1300.1(s)(i) requires that the suitability of all *positions* in the client’s account be reviewed when a suitability determination is required. Consequently, a suitability review of each deposit and transfer would need to be done before a subsequent order is accepted or one of the other trigger events occurs. As such, we believe the trigger event for deposits and transfers in proposed Rule 1300.1(r)(i) is unnecessary.

In the alternative, if IIROC wishes the trigger events to remain, the CRM Committee suggests a proposal for improvement. Transfers occur on a frequent basis and securities may be transferred in from other financial institutions over the course of time. The proposed Rule seems to indicate that a review would be required each time a security is received. The IIAC CRM Committee suggests a threshold be included in the proposed Rule by which the securities transferred in would have to be “material” in order for the trigger to be activated. While a materiality threshold would provide members with limited relief on systems and record keeping, it will not negate the need to monitor for the trigger and might in fact complicate the tracking process.

#### Rule 1300.1 (s) and Suitability of investments in client accounts

The CRM Committee seeks guidance on how IIROC expects a firm to set up a compliance structure to effectively supervise whether or not a suitability review of all positions in the client’s account has occurred and the client has received appropriate advice. The CRM Committee believes that to create such a supervisory system will require new data analysis, documentation, operations and compliance processes to be developed. This includes operational systems to track and monitor advice provided further to each suitability review. Firms currently conduct daily and monthly reviews and raise flags when it appears that a suitability issue has occurred. There will be significant supervisory challenges in meeting the new requirements. It is unclear what steps the dealer is expected to take in order to ensure that the client has received appropriate advice in response to a suitability review. The dealer cannot monitor all discussions or communications with clients. Moreover, it is not clear that the benefit of this enhanced supervisory obligation will outweigh the cost as this is fundamentally the IAs role and responsibility. As a result, we suggest that this provision be removed.

#### Relationship between 1300.1 and Rule 2500 and KYC Guidance Note

The CRM Committee finds that there is a great deal of overlap and confusion with respect to the provisions for multiple account applications and suitability provisions in the KYC Guidance Note as well as the requirements set out in Rule 2500. Some further clarification as to how they intertwine would be appreciated as well as how a member supervises these various factors. We believe the KYC Guidance Note and the proposed CRM Guidance Note should reflect these issues.

For example, the proposed CRM Rules allow combined relationship disclosure information where the client has more than one account, but separate account applications are required under the KYC Guidance Note if the client’s investment objectives and risk tolerance are not identical for all of the accounts. We believe these factors need to be reviewed and discussed together to provide greater clarity.

However, we wish to thank IIROC for the extensive changes it has made to the KYC Guidance Note based on comments previously received from the IIAC. Most notably, the revised KYC Guidance Note clarifies and removes references that appeared to create new requirements, the main concern being reference to the requirement for an annual suitability review and an annual material change inquiry. We also appreciate that references to CRM in the KYC Guidance Note were removed.

## **Conflicts Management and Disclosure**

The IIAC CRM Committee notes that the phrase “best interests of the client” has been introduced in the proposed conflicts of interest rules. We are concerned that referring to the “best interests of the client” in the context of the conflicts rules may be misinterpreted as creating a fiduciary duty in Canada. Our concern is heightened by the current dialogue surrounding the imposition of a fiduciary duty, most notably in the United States. While IIROC may not intend to create a new fiduciary duty, introducing the reference may create this impression and lead to confusion. Referring to “the best interests of the client” is not necessary in the context of the conflicts rules and has not been done in National Instrument 31-103, upon which the CRM conflict provisions are based.

It is suggested that IIROC consider the language in section 13.4 of the Companion Policy to NI 31-03, which uses the term “sufficiently contrary to the interests of the client.”

The CRM Committee would appreciate clarification around how the new conflict of interest rules would work in practice. The proposed CRM Guidance Note provides a number of useful examples of conflicts that are already described throughout the IIROC Rules, but the CRM Committee is most concerned with conflicts that are not currently prescribed and that advisors could face on a daily basis. The IIAC recommends creating a best practices guide for the industry on conflicts of interest which would outline various scenarios that dealers and advisors should be aware of. The IIAC would be happy to work with IIROC and our members to produce this document.

## **Client Acknowledgement**

The IIAC CRM Committee continues to have difficulty with the provisions of the proposed CRM Rules that require a client acknowledgement of the RDD and now the KYC. It is unclear why the RDD and now the KYC form are singled out as requiring an acknowledgement when firms routinely send other important documents such as confirms and statements that do not require an acknowledgement to their clients.

The logistics involved in being able to ensure that all clients acknowledge these documents is a huge concern for firms.

Furthermore, the value of having the client acknowledge receipt of the RDD and KYC form is unclear. The CRM Committee does not see obtaining an acknowledgement as enhancing investor protection but, to the contrary, as protecting the interests of the firm. The acknowledgement may assist the member in defending itself in the event a client disputes the suitability of investments in their account, but having the client acknowledge that they agree with the information does nothing to help the client.

In IIROC’s response to comments, IIROC failed to clarify what would occur in situations where the client refuses or forgets to sign or return the documents to the firm? Where a client refuses to acknowledge, does the account need to be closed or placed on a restricted list? During the time it takes to receive the signature or other form of acknowledgement from the client, can transactions continue to take place?

In regards to the current proposal, the IIAC CRM Committee would appreciate clarification with respect to obtaining a signature for the client acknowledgement. Page 32 of the proposed CRM Guidance Note indicates that obtaining a signature is a “best practice” but that there are other ways for firms to satisfy this requirement. However, Page 31 of the Guidance Note states that “where a signature *cannot* be obtained other forms of acknowledgement of client receipt such as a documented phone conversation or an e-mail or letter from the client will be acceptable.” [emphasis added] The Committee would appreciate clarification that a signature is indeed a best practice and that firms can use whatever method best suits their business model.

Clarification is also requested with respect to the KYC information that needs to be acknowledged. The current wording of the requirement uses the term “form” and the Committee would appreciate clarification that it is not mandatory that the actual KYC information be sent to the client but that some form of summary is also acceptable. Firms vary in practice as to what they send to clients and while some send a copy of the KYC documentation, many send a summary of pertinent information only.

Furthermore, the proposed KYC Guidance Note states that the recent amendment to IIROC Rules to implement the Registration Reform project “eliminated the use of the word ‘form’ from the term ‘new account application form’ to recognize the completion of account applications”. A similar change should be made in the drafting of Section XX07 of the proposed RDD Rule which still refers to the KYC information “form”.

If IIROC continues to maintain an acknowledgement requirement, the IIAC CRM Committee suggests that the acknowledgement for the RDD and the KYC be separated into two requirements. Furthermore, in respect of the KYC, the acknowledgement should focus on the initial KYC as opposed to amendments due to issues that could arise as described above where a client has a change in circumstance but has not acknowledged the revised KYC.

The IIAC CRM Committee would also like to ensure that IIROC is aware that firms will likely send out the RDD and KYC documents via a mass mailing as opposed to providing the documents to clients on a client by client basis. Given the three year transition time frame set out in the proposed CRM Guidance Note to provide these documents to existing clients, it appears IIROC may have thought this would be done on an individual basis. The logistics and tracking that would be involved in doing this on a one by one basis would be very onerous for firms and, as such, it is likely that many firms will opt to do a single mass mailing to all clients with the documents. Given that firms intend to send this to clients in the mail, the exercise of having to obtain a client acknowledgement is unrealistic and we request that IIROC eliminate this requirement. This would further provide consistency with the MFDA and NI 31-103, both of which do not require an acknowledgement.

### **Notice and Access - For Existing Clients**

The CRM Committee was disappointed that IIROC’s response to comments failed to address the IIAC submission with respect to a notice and access approach under the CRM proposal. As previously commented, a notice and access model differs from the concept

of an “access equals delivery” model where information is simply made available to clients through a website. Notice and access goes a step further by ensuring that information is effectively brought to the attention of the client.

A notice and access approach is beneficial to both clients and member firms. Clients would receive the RDD in a timely fashion and, at the same time, costs would remain under control. Further, by employing the principles of notice and access, clients would have easy access to the RDD without worrying at some later date that they have misplaced a paper version that was sent in the mail.

A notice and access approach is currently being developed by the CSA with the assistance of industry participants, as it relates to National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* (NI 54-101). Under the proposals being contemplated, issuers would be permitted to deliver information circulars and other meeting materials by posting them on a website and sending a notice to beneficial owners. Such delivery would be on an opt-out or implied consent basis, where beneficial owners must request paper if they choose to receive it in that form. It appears that this approach will be approved and very likely used for the 2012 proxy season.

We suggest that a similar approach be taken to the delivery of the RDD to existing clients. As quarterly account statements are required to be sent to all clients, the account statement could include a notice that the RDD is available at a specifically identified location of the firms’ website. Reminders could be included in all future account statements for the following year. As there will be physical changes to account statements with the implementation of CRM, members could include a note on the statement explaining that changes have been made as a result of the proposed Rules. That Note could include an explanation of the requirement to provide all clients with an RDD and the means to obtain such RDD through the member’s website. The link provided would directly access the appropriate RDD, to ensure clients need not search for the RDD from the member firm’s homepage.

To avoid the necessity of obtaining client signatures or other acknowledgements from existing clients, which would require enormous time and effort, we would suggest instead that, assuming the member can demonstrate that notice has been provided to clients regarding how and where to access the RDD, the delivery requirements would be met. Obviously, the notice contained in the account statement would advise clients that they may contact the firm or their advisor should they wish to receive a paper copy of the RDD.

At this point, the CRM Committee wishes to reiterate some of our previous concerns with a number of items in the proposed CRM Rules:

**Relationship Disclosure Document (RDD)**

Our members maintain their view that the revised RDD is still overly onerous and requires the preparation of a lengthy and detailed document which will demand an unreasonable amount of member time and effort to complete and which clients will not

likely read. The intended objective of the CRM, to have the client understand the relationship with their advisor, will therefore not be achieved. The current regulatory regime in Canada is already far too detailed and complex with rules that govern the advisor relationship with clients as well as the internal operations of firms. The proposed CRM simply adds to this regulatory burden.

In addition, the amount of paper being transferred between parties will be enormous. As of September 2010, the Investor Economics Retail Brokerage Report stated that there existed 5,568,000 full service retail accounts and 4,211,000 discount accounts in Canada. Assuming a 20 page RDD, this could create upwards of 195,580,000 pieces of paper which simply adds to the global environmental concern of an overabundance of paper being used where not essential.

Further, due to the highly prescriptive nature of the proposed RDD, significant and unnecessary costs will result both in terms of members complying with the strictures of the rule and the related regulatory oversight by IIROC sales compliance staff.

It should also be noted that the current wording of Rule XX05(2)(d)(iii) refers to the RDD containing “a statement indicating whether or not the provision of account percentage return information will be an option available to the client.” This statement does not appear to be reflective of the new requirement to provide percentage return information and we assume that this will be amended before the CRM Rules are finalized.

#### **Description of Approach Used to Assess Client’s Investment Suitability and KYC Information**

The proposed Rules require a description of the approach used by the member to assess investment suitability, including a description of the process used to assess the client’s KYC information, and a statement that the client will be provided with a copy of the KYC information that is obtained.

The difficulty with such a requirement, especially where the firm uses a customized document, is that every advisor engages in this process differently. The process to assess the client may occur through a detailed interview, a questionnaire or via the account opening document. Even in a face-to-face interview, no two advisors will pose the exact same questions. Therefore, how is such a description possible? Another undesirable outcome may be that description is so high level that it becomes meaningless.

As a result, we question the utility of this requirement and, in the alternative, suggest further discussion in the proposed CRM Guidance Note.

#### **Consistent Application with CSA and MFDA CRM Rules**

As in previous submissions to IIROC, the IIAC continues to raise serious concerns regarding some of the discrepancies between proposed IIROC and MFDA requirements. Such discrepancies create a separate standard of investor protection and impose a heavier cost burden on IIROC member firms.

IIROC indicated in its response to comments that “IIROC staff has made several changes to further enhance consistency in the approaches where applicable.” We see no indication of any amendments in this regard. Further, we do not believe that inconsistent approaches taken are the results of differences in business models/account offerings, as stated in IIROC’s response to comments. This does not explain the differences outlined in detail below.

It is important that both the content of the MFDA’s and IIROC’s proposed CRM Rules and the implementation process are harmonized, to ensure clients with MFDA firms receive the same protections in terms of mandated services and disclosure as the clients of IIROC firms. If there are differences in the content or the timing of implementation, these differences must be resolved before the proposed Rules are promulgated.

The CSA could play a useful role in promoting uniformity and standardization in the MFDA and IIROC rules related to the CRM. Moreover, a lack of uniformity in the proposed Rules creates unnecessary inconsistencies between MFDA and IIROC member firms. The regulators have an obligation to ensure the equity of regulatory treatment among investment dealers and mutual fund dealers, given the substantial burden of regulatory compliance.

There are also some fundamental differences between IIROC’s proposed Rules and the relationship disclosure information provisions in section 14.2 of proposed NI 31-103. Proposed NI 31-103 no longer requires a relationship disclosure document. Instead, section 14.2 provides a basic list of information items which will be required to be given to clients. This requirement is flexible in how it is met. In fact, the CSA states that they “anticipate that, in many cases, registrants will be able to satisfy this requirement using existing documents.” Separate documents, therefore, can collectively, satisfy the information requirements. This is a far different approach than that found in the IIROC proposed Rules which specifically requires a document entitled “Relationship Disclosure”.

Similarly, the MFDA proposal does not require an RDD and allows for the required disclosure to be disseminated in a variety of documents. This approach is a cost effective way of meeting the disclosure objectives for investors and is the preferred method of delivery for all required relevant disclosure. While incorporation by reference is an improvement over the previous IIROC proposal we still believe that the MFDA approach should be adopted and we request IIROC consider amendments to ensure all proposals are consistent.

Further, section 14.2 of NI 31-103 does not require a client signature, acknowledgement or audit trail to evidence the provision of information to the client. The Instrument also does not require partner, director or officer approval or the creation of an audit trail to ensure that the information has been provided to a client.

The requirement for relationship disclosure information in proposed NI 31-103 allows for an exemption for permitted clients, a new subset of the accredited investor category. We

would recommend that IIROC provide a similar exemption for permitted clients from the requirement to provide the IIROC RDD document to retail clients.

Rules with a common regulatory focus need to be harmonized as much as possible to achieve efficiencies and reduce compliance costs. Regulators should focus their efforts on achieving these harmonized standards as it is not apparent why different standards are imposed on different registrants. It is imperative that the RDD requirements are consistent and harmonized for all registrants before implementation. Canadian investors should receive the same disclosure across the regulatory spectrum.

### **Implementation Costs**

We believe that the implementation and ongoing costs associated with the CRM will be significant across the industry. It does not appear that IIROC fully appreciates the extent of the expenditures that will be required. Longer and harmonized transition periods should be adopted as they will help contain the cost of implementation.

The proposed CRM Rule, if adopted, will have a considerable impact on the operational aspects of members. In order to comply with audit trail requirements and enhanced supervision requirements, various start-up and ongoing maintenance costs will be expended in areas relating to reporting, systems, data analysis, documentation, operations, supervision and compliance.

Further, there will be operational and supervisory challenges as a result of the new requirements for enhanced cost disclosure and performance reporting. This includes establishing standards around the cost amounts to be reported and the designing and building of substantial new supervisory systems.

In addition, since the RDD will be mandatory for firms, it is unclear whether decentralized generation and delivery at the branch level will be acceptable or whether such documents will need to be produced and mailed to clients from a centralized area in the same manner as for transaction confirmations and account statements.

### **Transition Periods**

The IIROC Notice outlines the schedule for implementation of the RDD and gives six months to provide the RDD to new clients and three years for existing clients. The IAC CRM Committee has concerns with the timing of the production of the actual document which will include compiling all of the newly required information. This will consist of not only creating the RDDs but also the material needed to satisfy the disclosures outlined in the RDD. For example, updated systems and record keeping will be necessary for the new suitability requirements, new obligations surrounding the Dealer Member's requirement to conduct suitability reviews, revised client acknowledgement requirements and revisions to the documentation, operations and supervision surrounding conflicts of interest. Sufficient time will also be required to ensure accurate translation of the document which is always challenging for firms and takes a considerable amount of time.

Given the amount of work required, the IIAC CRM Committee request that a minimum 12 to 18 months be provided for delivery of the RDD to new clients to ensure the information provided is meaningful.

It should also be noted that the MFDA has ultimately, from the finalization of CRM rules to the implementation date, provided its members with a ten month transition period. Given that the IIROC proposal is more onerous and the MFDA proposal does not require an RDD document, IIROC members should be afforded at least 12 to 18 months to comply.

Proposed transition periods have been set out in Attachment E of the IIROC Notice. However, the transition periods have not been included in the proposed amendments to the IIROC Rules. This has led to some confusion regarding when the new rules will come into effect. We assume that when the rule amendments are finalized, the transition periods will be included in the rules that they relate to. Please confirm.

A discussion with respect to transition periods for performance reporting is discussed below.

### **Performance Reporting**

The IIAC CRM Committee continues to have numerous concerns with the proposed performance reporting requirements, which are set out in detail below.

#### **Implementation of Performance Reporting Requirements**

The implementation period for any new requirement in the area of performance reporting needs to ensure that it is sufficiently long enough to address all issues. Attachment E of the IIROC Notice sets out the time frame for implementation of the CRM proposal and indicates that member firms will be provided with one year to comply with security position cost disclosure and account activity disclosure and two years to comply with the account percentage return disclosure requirements. The IIAC CRM Committee requests that these time frames be extended to a minimum of three years for all account performance reporting requirements from the date of implementation.

Firms have many competing priorities that need to be addressed and generally priorities are set at a minimum 12 months in advance. Firms require sufficient time to ensure that the performance information they will be providing to clients is accurate and free from errors. The process of ensuring that the quality of the information supplied is meaningful will be a huge undertaking. Many firms currently provide performance reporting to only a small segment of their clients and the work involved in expanding this to all clients will be extensive. As such, to produce this information for all accounts will take at minimum 24 to 36 months to fully organize the information, adjust systems and refine processes.

The IIAC CRM Committee suggests that IIROC consider the use of a phase in system for implementation of the performance reporting requirements. This could allow firms to test systems and ensure that rules can be met or that firms are on their way to meeting the requirements. Milestones could be set to ensure that firms are progressing in meeting a

2014 deadline which would provide IIROC comfort that firms were working towards implementing the requirements. The IAC would be pleased to work with member firms and IIROC in organizing such a phase in system.

The current implementation time frame for providing the RDD to existing clients is set at three years. The IAC CRM Committee is of the opinion that the requirements to implement performance reporting are as challenging, if not more challenging, than those required to implement the RDD. As such, the Committee suggests that IIROC create consistency in the implementation of time frames and extend the transition periods for implementing performance reporting to three years.

We also note that the CRM Guidance Note states that “in order to avoid having to regularly update the client relationship disclosure they are being provided, it may be more efficient for the Dealer Member to inform the client of its plans over the 2 year implementation period, so that the client is informed up-front as to the types(s) of performance reporting they will be provided.” However, the IIROC Notice states that the performance reporting rules are still subject to approval by the CSA and that the CSA may in fact decline to approve these rules. The CRM Committee has concerns as to how a firm can inform clients of their performance reporting plans if the rules are not immediately confirmed. If the performance reporting provisions are eventually revised by the CSA, how can firms avoid resending new RDDs to their clients? The CRM Committee suggests that IIROC and the CSA quickly resolve this issue prior to RDDs being developed by firms and agree that the wording in the RDD will not specifically speak to future plans and that they will not expect firms to update clients that have already received the RDD.

### Application of Performance Reporting

IIROC dealer members service a wide array of client segments, each with different needs and expectations. IIROC’s proposal, however, mandates performance reporting for all retail client accounts, regardless of whether or not clients want, need or are willing to pay for the information.

The costs required for dealers to implement the IIROC performance reporting proposals will be material. Ultimately, it is the dealers’ clients that bear these costs. For many clients, these additional costs will outweigh any of the perceived benefits from mandated performance reporting. For example, some clients have no need for mandated performance reporting from their dealer because they already have in their possession the necessary information for them to perform their own evaluation on the performance of the account. Members also note that many of the ‘managed accounts’ very popular today among their clients already provide suitable performance reporting and hence yet another reason why many clients have no need for mandated performance reporting. Lastly, other clients may simply have little or no interest in performance reporting, placing a greater priority instead on the level of service they receive from their advisor and the level of trust built over the course of years or decades in maintaining a relationship with the advisor.

A legitimate concern raised by members of the IIAC CRM Committee is that the performance reporting proposal may make servicing some accounts uneconomical. Dealers will have to be more critical with respect to the types and sizes of accounts they continue to administer. A possible unintended consequence of the performance reporting requirement, therefore, is that fewer individuals may continue to have access to the guidance of a full-service advisor at an IIROC regulated firm. To address this concern, our CRM Committee strongly recommends that a minimum portfolio size threshold be established for which performance reporting would not be mandated by IIROC. The threshold recommended is \$100,000 and we would recommend that this be valued annually and reporting be provided in the following calendar year.

The Committee would also appreciate clarification as to the scope of the performance reporting requirements. Do the requirements only apply to Canadian based clients or do they extend to international clients as well? The Committee suggests that the requirements only apply to Canadian based clients.

#### Security Position Cost Disclosure

The CRM Guidance Note states that security position cost information will be required to be provided to all retail clients annually. The Guidance indicates that since IIROC could not reach a consensus in 2008 with respect to whether members preferred using original cost or (book) tax cost to formulate the information, IIROC determined that original cost provides the most useful information for the purposes of account performance and therefore, has mandated this form of disclosure.

The IIAC CRM Committee is of the view that IIROC should not mandate which form of cost should be used in producing the report and instead leave this up to each firm to decide. Allowing firms to choose their own methodology and provide the appropriate disclosure to clients will benefit clients and firms alike. Firms should be permitted to make their own choices that best suit their technology and business models. Firms should, however, be expected to adequately disclose to their clients how they determine cost base.

If IIROC is unwilling to adopt a flexible approach to reporting, the IIAC CRM Committee is of the opinion that tax cost is the more appropriate measure. The Committee requests that IIROC once again reach out to members to ensure they are mandating the preferred option. IIROC examined this issue in 2008 and views may have shifted over time as the members of the IIAC CRM Committee have indicated that they are in favour of using tax costs where a flexible approach is not acceptable to the regulator. Many firms already track tax cost and while it is not insurmountable to ask the service providers to develop the methodology to track and populate original cost data in their systems, it will require significantly more lead time to prepare for than reporting tax cost. Furthermore, since account activity disclosure reporting requires members to disclose the cumulative realized and unrealized capital gains/losses on the client's account, tax cost will be needed to calculate these positions and therefore consistency between the two performance reports is appropriate. Additionally, security positions transferred via ATON today are done using tax cost.

There has been a significant investment made by many of our members to integrate the account transfer applications with CDS-ATON functionality. Tax cost fields in most systems report tax cost to ATON. Therefore, Dealer Members do not provide original cost when transferring a retail account from one dealer to another. Inability to properly track original cost on securities held in accounts transferred between Dealer Members will limit the ability of the industry to comply with original cost base reporting requirements. The cost and development time for Dealer Members and/or CDS to add original cost on dealer to dealer transfers is unknown at this time. Even with the appropriate development, it seems inevitable that tracking original cost for account holders who move their accounts between Dealer Members is likely to be problematic.

Further, not all Dealer Members consistently provide cost information on non-registered accounts. With no mandatory requirement for IIROC members to provide cost information on all external transfers, it will be difficult for Dealer Members to report original cost on all accounts unless information is provided by the client.

Furthermore, there are products where original cost may not be appropriate or relevant information to the account holder. NHA mortgage backed securities that pay a portion of the investor's original principal each month or mutual funds that pay a return of capital regularly or periodically are examples, and are described below.

NHA MORTGAGE BACKED SECURITY BANK OF N.S. POOL #97010698

CUSIP: 62922ZLB1

Issue Date: 03/01/2009

Maturity Date: 08/01/2011

Assuming an initial investment of \$10,000.00, this becomes the original cost amount. The security's current market value as at 02/07/2011 would be \$2,836.50 based on a price of 28.365. With each month's payment, our system marks down the cost of the investment by the principal portion of the monthly payment. In this example, displaying original cost along side market value may give a less sophisticated investor the impression their investment had performed poorly whereas tax cost reflects the monthly reduction in principal paid since the bond was issued.

Another example of the problems that can occur can be highlighted with mutual funds. While mutual funds are typically an investment commonly referenced where original cost is the most appropriate value to display to an investor, many fund managers supplement fund generated income and/or capital gains with return of capital to meet their distribution requirements. Any amounts paid out as return of capital should be offset against the investor's original cost base. There is no known process for Dealer Members to do this other than reporting the fund's cost base. Canadian mutual fund manufacturers universally report tax cost today.

As such, the IIAC CRM Committee request that where a choice is not given to members that IIROC mandate Dealer Members using tax costs when reporting such positions to clients.

### Account Activity Disclosure

As stated above, firms will need to determine tax cost in order to report capital losses and the IIAC CRM Committee believes that the cost base for the various performance reports should be consistent and therefore tax cost should be used.

As we have previously commented, we note that the MFDA proposes to mandate account activity disclosure for the current year only and, as such we request that IIROC amend their proposal to eliminate cumulative reporting and only require reporting for the current year.

### Account Percentage Return Disclosure

The CRM Committee suggests that account percentage return disclosure be mandated in terms of producing the information but that IIROC not mandate how the information is delivered to clients. The Committee suggests that the information be available electronically to client and will only be provided in hard copy to clients where specifically requested, given the relatively high costs associated with having to send this information to all retail clients.

Firms estimate that the cost associated with sending this information in hard copy to all retail clients would be approximately \$50,000,000 a year across the industry. This cost is in addition to the costs firms will encounter in having to store all of this data in the event the client is interested in receiving the information.

With respect to the 1, 3, 5 and 10 year reporting requirement, the IIAC CRM Committee request that this provision be removed as this is not required in the MFDA proposal and again, we request a consistent approach for the capital markets as a whole. If IIROC insists on retaining this provision, the Committee would appreciate clarification that the requirement to report this information is only mandated on a prospective basis as this appears to be stated in the proposed CRM Guidance Note but not in the proposed Rule.

### **Conclusion**

In closing, while the IIAC and our members support the principles behind the CRM, we believe that many concerns and issues as outlined above and in our previous submissions continue to need considerable attention.

The IIAC would be happy to work with IIROC to improve the proposed CRM Rules to ensure an appropriate model is developed which will enhance the experience investors have when working with our member firms.

Yours sincerely,

*“Ian Russell”*

cc: Larry Waite, President and CEO, Mutual Fund Dealers Association of Canada