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CRM2 and Investor Behaviour

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& SUI® Instructor

IIAC Compliance and Operations Symposium
Toronto, February 27, 2014





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The Fund's Return

Benchmark return

± Impact of portfolio manager's decisions

- Trading expenses

= **Gross return**

- Fees and expenses

= **Portfolio manager's or fund's return***

* This is the time-weighted return.





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The Investor's Return

Portfolio manager's or fund's return

- Sales charges and deferred sales charges

± Impact of investor's decisions

= **Investor's personal return***

- *Income tax*

= **Investor's personal return after tax**

*** This is the money-weighted return before tax.**





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What Should Investors Focus on?

Benchmark return

\pm *Impact of portfolio manager's decisions*

= Portfolio manager's or fund's return

\pm *Impact of investor's decisions*

= Investor's personal return

- *Income tax*

= Investor's personal return after tax





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What's in It for Investors?

- Excessive trading 100-150 basis points
- Tax 50 basis points

150 to 200 basis points *each year*





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The Way Forward

- The Challenge:
Realise CRM2's potential to improve investor behaviour
- Pre-requisite:
Investor education and support



CRM2 Panel

February 27, 2014



Agenda and Speakers

Moderator

- Rebecca Cowdery, Partner, BLG

IIAC and CRM2 survey results

- Barbara Amsden, IIAC

Large firms and service providers

- Dave Malone, VP – Business Initiatives, RBC
- Paul Strijckers, VP, Strategic Initiatives, Broadridge

Introducing and carrying brokers

- Brian Driscoll, VP, Associate PM, BBSL
- Clint Arthur-Wong, Sr. Risk Manager, NBCN

Background

- 2004: CSA Fair Dealing Model paper
- Sept. '04: Registration Reform Project
- March '12: IIROC CRM1 amendments re relationship disclosure, conflict of interest, enhanced suitability
- March '13: CSA CRM2 pre-trade, confirm, statement, position cost, annual fee and performance reports
- Dec. '13: IIROC draft equivalent
- Feb. '14: IIAC response to IIROC CRM2, part 1*

(<http://iiac.ca/wp-content/uploads/IIAC-Letter-to-IIROC-and-CSA-on-CRM2-July-15-2014-Disclosure-Requirements.pdf>)

Only Two Years to Prepare...





CRM2 Committees

- CRM2 **Implementation** Working Group
- **Communications** Working Group
- **Market Value** Working Group
- **Mutual Funds** Working Group
- **Reporting Prototypes** Working Group
- Other related (*ESSRWG, HTVSWG*)
- To join: awalrath@iiac.ca or bamsden@iiac.ca

Sporting Equipment

<http://iiac.ca/wp-content/uploads/CRM2-Reporting-Toolkit-February-27-2014.pdf>

- Regulatory documents and responses
- Plan-on-a-Page: overview/timing of CRM2 rules
- Quick fields: report frequency, format, exclusions
- Compensation and performance data maps
- Events
- Surveys
- Communications
- Industry-wide project plan (*in development*)
- Other
 - Asset Classification Schema
 - Adjusted Cost Base (Book Cost) Matrix

Survey Results

Methodology and respondents

- Respondents: 43 (37 disclosed)
- Respondent break-out:
 - Integrated 8
 - Retail – self-clearing 13
 - Retail – introducing 16
 - Carrying broker 4
 - Online discount 4

Survey Results

What stage is your firm at regarding...?

	Implementing	Mostly Complete	Enhancing	Other	Total	
Enhanced suitability	3	4	11	22	3	43
Relationship disclosure	2	7	10	24	0	43
Conflict of interest	2	3	6	32	0	43

Takeaway: You're not alone

Tip: Start with the basics

Survey Results

How is your firm going to implement CRM2?

	Response #	Response %
Through systems as much as possible	27	63%
Manually	2	5%
Through systems ultimately, but manual work-arounds for now	14	33%

Survey Results

How will you tell clients of benchmarks?

	Response #	Response %
With account statements	34	79%
Other client mailings	13	30%
Other (please specify)	8	19%



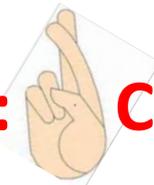
Would you support standard benchmark notices?

	Response #	Response %
Yes	35	81%
No	5	12%
Don't know	3	7%

Survey Results

How do you plan to do pre-trade disclosure?

	Response #	Response %
Oral, document via note to file	28	65%
Oral, document via system flag	9	21%
E-mail	8	19%
Click “I accept” on website	7	16%
E-mail standard price list; refer	11	26%
Other (please specify)	15	35%

Good News:  **CSA expects to delegate CRM2 to IIROC**

Survey Results

Will you be tailoring/varying disclosures?

By product/client	Response #	Response %
Yes	15	45%
No	8	24%
Maybe	7	21%
N/A or no answer	3	9%

After time	Response #	Response %
Yes	14	37%
No	24	63%

👉 What do regulators expect? (policies? prove it.)

👉 What will clients accept?

Survey Results

What will you report on debt trade confirms?

	Response #	Response %
Total compensation	13	33%
Gross commission, if any, and, if firm applied other mark-up/down, a notice	26	67%



Good News:

IIROC and OSC both say accuracy beats similar

Survey Results

Plans regarding off-book?

Intend to deal with...	Response #	Response %
Yes	13	30%
No	23	54%
Don't know	7	16%

Plans include...	Response #	Response %
Educate client	7	41%
Provide incentive	4	24%
Work with manufacturers	1	6%
Hold with affiliate	0	0%
Other	9	53%

Tip: There may be more than you knew
👉 How do you remove?

Challenges

The letter of the law



What can be done

in time available

The spirit of the law

CRM-2 Process Changes

Implementation Considerations



Broadridge[®]

February 27, 2013

CSA Timelines for NI 31 – 103 (CRM-2)

■ July 15, 2014:

- 14.2.1 -pre-trade disclosure of charges
- 14.12 -content and delivery of trade confirmation on Debt Securities

■ July 15, 2015:

- 14.11.1 determining market value
- 14.14.1 additional statements, 14.14.1(3) that advisers must provide monthly statements if requested by a client.
- 14.14.1 (5) Client Name reporting
- 14.14.2 original cost and book cost

■ July 15, 2016:

- 14.12(1)(c) -DSC charge disclosure on Confirms
- 14.17(1)(h) -Report on charges and other compensation
- 14.18/14.19 -Total Percentage Return and content

IIROC's Timelines for CRM-2

■ July 15, 2014:

- Section 29.9 -pre-trade disclosure of charges
- Subparagraph 200.2 (l) (v) (A,B,&C) -content and delivery of trade confirmation on Debt Securities

■ July 15, 2015:

- Subsection 200.1 (c) determining market value
- Subsection 200.2 (e)(i) Client Name reporting
- Subsection 200.1 (a,b, & e) original cost and book cost

■ July 15, 2016:

- Subsection 200.2 (l) -DSC charge disclosure on Confirms
- Subsection 200.2 (g) -Report on charges and other compensation
- Subsection 200.2 (f) -Total Percentage Return and content

July 15, 2014

July 15, 2014 – Pre-trade Disclosure

▪ Section 29.9 -pre-trade disclosure of charges

Overview:

- Retail accounts only
- Reasonable estimates are acceptable
- Purchase or Switch of DSC Securities; and
- Other transaction which may compensate the dealer
 - disclose that DSC might be triggered upon redemption & Presentation of DSC Schedule
 - Client pays directly or indirectly
- **TIP: Purchase of securities with “trailing commission” are not just mutual funds**
- **TIP: Look at product types one by one; look at all fee types**

July 15, 2014 – Pre-trade Disclosure

■ **Process changes:**

- Source of Data:
 - DSC
 - Other securities where compensation is received
- **What will the firm's policy be to implement Pre-Trade Disclosure Charges?**
 - Verbal:
 - Provide a script to Advisors
 - Document pre-trade disclosure; What & how?
 - What process/education will be enforced to remind Advisors
 - Systems:
 - Captured within Order Management systems? Fixed or Free format? Mandatory edits?
 - Other communication methods: Smart Advisor solution? email?
 - How will this process be audited?

July 15, 2014 – Confirms for Debt Securities

■ July 15, 2014:

■ Subparagraph 200.2 (l) (v) (A,B,&C) -*content and delivery of trade confirmation on Debt Securities:*

- *Disclose Total Dollar amount of compensation taken on the trade (mark-up or mark-down, commission or other services charges)*

Or

- Total amount of commission (if any) and/or substantially similar to:

“Dealer firm remuneration has been added to the price of this security (in the case of a purchase) or deducted from the price of this securities (in the case of a sale). This amount was in addition to any commission this trade confirmation shows was charged to you”

IIAC RECOMMENDATION

Dealer firm remuneration may have been added to the price of this security (in the case of a purchase) or deducted from the price of this security (in the case of a sale). If remuneration has been added, it would be in addition to any commission that may have been charged to you. [*proposed amendments underlined*]

July 15, 2014– Confirms for Debt Securities

■ **Process changes:**

- Which method will be used?
- How & where will this be calculated?
- How will this be processed?
- Impact on downstream processes:
 - End user websites
 - Desktops for Advisors
 - Confirms
 - Print vendors

July 15, 2015

Subsection 200.1 - Determining market value

- Funds to use NAV
- Quoted on marketplace:
 - Long positions- Bid Price
 - Short positions – Ask Price
- Fixed Income: published market reports/interdealer quotations or based on reasonable yield rates.
- Money market: based on current yield
- Apply firm policy for determining market value
- If firm policy is applied, then add/substantially similar:
 - “There is no active market for this security so we have estimated its market value.”
- If no value, then add/substantially similar:
 - “Market value not determinable”

Examples of Effect Securities Valuation:

- Symbol: NXJ (Feb 19, 2014)
 - Trade Range for the day: \$2.21 - \$2.25
 - Volume: 9,400
 - Close: \$2.25 (Previous Close \$2.20)
 - At the closed:
 - Bid=\$2.15 (4-5% difference)
 - Ask=\$2.25

Subsection 200.1 - Impact of New Securities Valuations

- Clarification required on valuation of securities versus CRA requirements:
 - transferred in/out, contribution/distribution value:
 - Bid is the price one is willing to purchase at
 - Ask is the price one is willing to sell at
 - CRA requires Fair Market Value:

“Fair market value generally means the highest price, expressed in dollars, that a property would bring in an open and unrestricted market, between a willing buyer and a willing seller who are both knowledgeable, informed, and prudent, and who are acting independently of each **other**. ” (<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/csp/csp-f02-eng.html>)
- Retail client impact:
 - Not comparable to Media quotes (newspaper, internet, TV)
- Differences methods between Retail Accounts and listed securities held by Mutual Funds

Subsection 200.1 - Impact of New Securities Valuations

- Identify system and process which will be impacted:
 - Security master and associated pricing data
 - Statement process
 - Statement layout/notations (running out of space)
 - Client Reporting
 - Performance engines
 - Fee systems
 - Transfer systems
 - Web/Desktop presentation layer
- Need to develop a pricing policy

Subsection 200.1 - Last trade for transfers, bid/ask for positions

At month end:

- Imagine a stock with a Bid of \$0.10, Ask \$0.15, last trade of \$0.12.
- Transfer in 10,000 shares.
- The transfer in is worth \$1200, but the resulting position is only worth \$1000. An instant loss of \$200.

Subsection 200.1 - Impact of new securities valuations

- Source of Securities valuation
- Do you have the coverage for bid and ask
- Enhance firm policies on valuation of securities:
 - Identify new securities with no price
 - Identify securities not being priced
 - Identify securities for firm estimate
 - Identify stale prices
 - Securities valuation will be critical for Performance Reporting
- Add additional resources/tools to securities pricing

Subsection 200.1 - Impact of new securities valuations

- Identify system and process which will be impacted:
 - Security master and associated pricing data
 - Statement process
 - Statement layout/notations (running out of space)
 - Client Reporting
 - Performance engines
 - Fee systems
 - Transfer systems
 - Web/Desktop presentation layer

Subsection 200.2 (d)(i) - Account Statements

- Status quo on frequency: Monthly if activity & Quarterly if only Dividend & Interest
- Denote whether the securities are covered under an investor protection fund and name the fund – Section 29.14 – existing rule
- Denote which securities might be subject to a deferred sales charge if they are sold – Paragraph 200.2 (d) (iii)

Paragraph 200.2 (d)(iii) Challenges for Account Statements

- Disclosure of securities subject to a deferred sales charge
 - Source of DSC indicator
 - How do we determine if DSC are applicable? Is “DSC” in the name of a mutual fund enough?
 - What if a DSC fund has been held past the DSC schedule?
 - How to display the DSC indicator? As another column/symbol in the holdings section or create a new section that lists special securities?

Subsection 200.2 (e) Additional Statements – Client Name

- Statements of securities held by a party other than the dealer or adviser (a.k.a client name accounts, off-book accounts) on which the Dealer receives continuing compensation:
 - Statement required at the end of each quarter -10 days after nominee statements
 - Disclose the name of the party that holds or controls security as well as a description of the way it is held
 - Disclose that the securities are covered not covered by the Canadian Investor Protection Fund; and if these are covered under any investor protection fund and name the fund
 - Disclosure that deferred sales charges may apply to applicable securities when sold

Subsection 200.2 (e) Additional Statements – Client Name

- Identify if you have assets held away and receiving compensations:
 - Mutual Funds: Month End Rec Files (Nominee, Client Name, & Intermediary)
 - Other assets held elsewhere
- Business decision: Do you want to maintain such business
- Can your current system handle these assets or do you need to upgrade system or new system
- New processes and down stream affects to maintaining such accounts:
 - Reconciliation
 - Systems/Displays
 - Reports

Subsection 200.2 (e) Additional Statements – Client Name

- Statements requirement:
 - How do we determine the name of the party that holds / controls the position along with the description of how the position is being held?
 - How do we determine if DSC are applicable and how to display it on statement (same question as for account statements)?
 - Investor protection disclosure

Subsection 200.1 (a & b) Original or Book Cost by Position

“book cost”

- Long position: The total amount paid for the security, including transaction charges, adjusted for reinvested distributions, returns of capital and corporate reorganizations
- Short position: The total amount received for the security, net of any transactions charges, adjusted for any distributions, returns of capital, and corporate reorganizations

“original cost”

- The total amount paid to purchase a security, including any transaction charges related to the purchase
- **Transfer in: if “cost” is unknown; uses Market Value of security.** Notation must be provided if Market value is used for cost value.

Subsection 200.1 (a & b) Cost: Known Problems

-  Checklist
- Improper configuration of transactions codes
 - Not enough care taken in transaction code setup.
 - For Return of Capital, errors in configuration can have more pronounced effect.
 - Review of transaction codes used by your firm may be necessary.
 - More care needed in future!
- Improper processing of journals
 - Complex aspects of cost: including re-orgs, returns of capital or re-invested dividends.
 - **Transfer in: Originating firm uses "Original Cost" or unknown.**
- Identifying suspected data and ability to fix it
 - Tools/reports

Subsection 200.1 (a & b) Cost: Known Problems

- System deficiencies. (aka bugs)
 - Need to identify deficiencies
 - How will this be remedied?
- System limitations. (non bugs)
 - Retroactive Cost adjustments can be problematic when the target position has subsequently been transferred or gone through a re-org.
 - Return of Capital
 - Manual adjustment of the transfer cost is necessary or alternative processes created.
- Operations staff will need to understand the impacts of using the correct/incorrect journals/transaction codes

July 15, 2016

200.2(I) Addition of Deferred Sales Charge (DSC)

- On Confirms: The amount of each transaction charge, deferred sales charge or other charge in respect to the transaction and the total amount of all charges in respect of the transaction
- New Confirm file requirements
- Confirms
 - Presentation of data
 - Is there enough room?

200.2 (g) Report of charges and compensation

- Requirements to deliver report on charges and compensations
 - Based on a 12-month period
 - Exemption for accounts held less than a year
 - Applies to both nominee and client name accounts
 - Direct and indirect fees paid to Dealer
 - Total amount of each type of payment
 - Presentation can be done using a separate report or combined with the statements which investors have been receiving
 - Must have an explanation of what trailing commission is. Suggested wording is provided or firm can have substantially similar language
 - May be mailed with statement or up to 10 days after the statements
 - If consolidation is done, it must be the same accounts as the performance reporting

200.2 (g) Report of Charges and Compensation

Amended NI 31-103 Section 14.17

Operational Charges	Transactional Charges	Other Charges
Firm's current fee schedule		
<ul style="list-style-type: none"> Each charge applicable to the account 	<ul style="list-style-type: none"> Each charge related to a purchase / sale 	<ul style="list-style-type: none"> Unpaid amount of any enrolment fee for Scholarship Plan Dealers
<ul style="list-style-type: none"> Total of operational charges 	<ul style="list-style-type: none"> Total of transactional charges 	<ul style="list-style-type: none"> Total amount of charges other than trailing commission, e.g. referral , success or finder's fee
		<ul style="list-style-type: none"> Total amount of trailing commission

Assume: Issuers will send data, e.g., trailer fee files

Challenges / Discussions

- Source of data
 - Assumption that Mutual Fund manufactures will produce ESG files with detail trailer fees at account level
 - How about other charges? What are they and how do we get them? The Companion Policy (CP) mentioned the **need to disclose referral / success / finder's fee**
 - For debt related transactions, how do we calculate the mark up / mark down as well as other applicable charges?
- Importance of using appropriate transaction codes
- Complexities increase when dealing with client name/off book accounts
- Will the report be combined with the Statement or separate?

200.2(f) Percentage Return and Content

- Investment Performance Report
- Money Weighted method (aka IRR)
- Every 12 months
- May be integrated into statements, but not required to be.
- May be mailed with statement or up to 10 days after the statements
- Comes into force July 15, 2016 (Start collecting data from July 15, 2015? – to be clarified)
- If consolidation is done, it must be the same accounts as the Charge/Fee reporting

Performance: Comparison

Entity		Performance
Benchmark S&P index		Weighted
Canadian M Funds		Weighted
Retail Acco Equity Sec Listed Opti		Weighted

Performance

- Do you have an performance engine that can accommodate Money Weighted (IRR) method
- Have you tested the volumes?
- Integration to systems
- Support/Verification Team for Advisors/Clients
- Education and tools for the Advisors
- Report Delivery:
 - Design/format/content of report
 - Incorporate with Statement or separated
 - If combined, how many days of delay can your firms accept to incorporate investment performance data.
- Market Value of inflows/out flows will be critical

Performance

- Operationally:
 - Securities that are not priced
 - New Securities
 - Transfer in/out (Contribution/Distribution)
 - Will need to constantly monitor (i.e. daily/weekly)
- Need be aware of unique situations and impact on ROR, examples:
 - Account has no assets and trading starts:
 - Account has no assets, is cross guaranteed, and trading starts
 - An account with a negative equity value (Short positions, much too little cash to cover in the account, but with another account with sufficient credit as guarantor).

Check List:

- Read the proposed rules:
 - Client Relationship Model – Phase 2 Performance Reporting and Fee / Charge Disclosure Amendments to Dealer Member Rules 29, 200 and 3500 and to Dealer Member Form 1
 - <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=7EF9BAF618B24A0CA75B9C33D30FDD52&Language=en>

Attachment A: Proposed amendments to Dealer Member Rules 29, 200 and 3500 and Dealer Member Form

- <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=20D2413C9BD5428798A596F1653CD7EF&Language=en>

Attachment B: Comparison of equivalent IIROC CRM2 Amendment and CSA CRM2 Amendment provisions.

- <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=6876561061014AEABD1BF2BCC4495C50&Language=en>

Check List:

- Verify Proposed rules to existing/new processes/output:
 - DSC/Trailer Fees from Mutual Funds
 - Fee arrangement on other Securities
 - Confirms: Retail Accounts/Managed Accounts/DAP
 - Statements: Retail Accounts/Managed Accounts
 - Client Name/Off book holdings where compensation is received
 - Performance Engine (Money Weighted, expertise, scale, integration, & reporting)
 - Fee/Charge (sources, data acquisition, consolidation, & output)
 - Identify what operationally/technology needs to change and when
- Involve Operations, Finance, Technology and Business sides in reviewing the proposed rules



Burgeonvest ♦ Bick

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- BBSL is a Type 2 Introducing Broker to NBCN
- BBSL does not have a Trade Desk of its own.
- We are virtually 100% Retail.
 - Commission-Based Accounts
 - Fee-Based Accounts
 - Managed Accounts



March 26, 2014

- Account Relationship to All Existing Clients

July 15, 2014

- Pre-Trade Disclosure
- Expanded Relationship Disclosure
 - CRM Disclosures
 - Conflicts of Interest Disclosure
 - Services & Compensation Disclosure



July 15, 2015

- Additional Statements
 - Special Purpose Reporting
 - Off-Book (mutual fund) accounts in Client Name
 - Consolidated Statements

(Total reliance on our Carrying Broker)

- Who will bear these increased costs?

July 15, 2016

- Report on Charges & Other Compensation
- Investment Performance Reports

(Total reliance on our Carrying Broker)

Small Dealer Issues

Hard Dollars: Lots of Cash

Soft Dollars: Much more so Human Beings

CRM is like an acquisition:

- Easy part is doing the deal
- Hard part is maintaining the operations going forward.

Small Dealer Issues

- Dealing with Regulators
- Dealing with Advisors
- Dealing with Investors

GO TEAM GO!

