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ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Mr. Richard J. Corner
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Dear Mr. Corner:

Re: IIAC Response to IIROC September 18, 2014 Proposed Rule Amendments

We are responding to IIROC's Notice 14-0214, released on September 18, 2014, titled "Client Relationship Model – Phase 2 *[CRM2]*, Performance reporting and fee/charge disclosure amendments to Dealer Member Rule 200 and to Form 1 that are scheduled to become effective on either July 15, 2015 or July 15, 2016" (the "Proposed IIROC CRM2 Amendments"). Our aim in providing these comments and making these recommendations is to effectively achieve the goals of reporting for investors according to the principles and spirit of the CRM2 initiative, enhancing financial literacy and investor education and meeting other investor needs and expectations.

Priority Issues

1. Investor-Friendly Implementation of Annual Performance and Fee/Charge Reports

We appreciate IIROC efforts to help address IIROC dealer questions by issuing FAQs regarding some of the issues that have arisen during CRM2 implementation as quickly as possible. Our members also value IIROC's participation in the Canadian Securities Administrators (CSA)/Self-Regulatory Organization (SRO)/Association CRM2 Forum sessions organized to address cross-industry segment

concerns. Finally, we applaud the stated efforts and intent of the CSA and SROs to announce needed changes shortly so that development can continue expeditiously.

We have elaborated on the significant and complex development and other changes needed to implement CRM2 requirements at the August and October CRM2 Forums. Joanne De Laurentiis, President and CEO of the Investment Funds Institute of Canada (IFIC) – at a November 12, 2014 Financial Literacy Forum – referenced the huge systems build so that data for the new reports can flow directly into the mutual fund accounts of 4.3 million households and the "need to get it right". This applies even more so to IIROC dealers and advisors. IIROC dealers have a broader range of account types, offer a wider variety and greater number of public and private investment vehicles, and correspondingly have the most extensive new CRM2 requirements to meet. Among other things, IIROC-regulated dealers require a significant amount of time to:

- Enhance and validate data quality;
- Build/implement new systems to generate the new reports;
- Conduct complete regression and integration testing;
- Develop and roll out training to advisors; and
- Prepare explanatory material for clients.

The implementation timeline for the above already is proving to be extremely tight and that is without taking into account the effects or potential impacts on the CRM2 schedule of:

i. Changes in the Proposed IIROC CRM2 Amendments (see 5. below) and possibility of further changes;
ii. Revenue Québec reporting requirements for the 2015 year that relate to the same data field to be used for position cost (see 2. below);
iii. New securities rules expected in late 2014, 2015 and 2016, which require programming involving the same systems and involve some of the same project management, business analyst and IT resources in development as the CRM2 requirements do; and
iv. Other tax and non-securities-related rule changes that must also be implemented at this time.

While we strongly believe investors will prefer a calendar-year performance and fee/charge report, and our members therefore prefer the first performance and fee/charge report be based on a calendar-year, the complexity of the build and other tasks referred to above, with the over-arching need for accuracy, will force some members, potentially many, to a non-calendar-year performance report in order to leverage the maximum development time under the current set of regulations. Beginning with a non-calendar year reporting cycle (e.g., July 15, 2016 through July 14, 2017), and subsequently transitioning to a calendar year, presents additional difficulties and will certainly lead to increased client confusion.

With accountability for confidence in the capital markets, and recognition of the significant complexity associated with CRM2, Canada's securities regulators have a responsibility, we believe, to consider and ensure that the implementation of the CRM2 regulations aligns with investor expectations and achieves the goals of increased transparency. For this reason, we believe that allowing for a 2017 calendar-year performance report with a minimum of two comparable periods (2017 and a since-inception report of 2016 and 2017) with a fee/charge report for 2017 has two significant benefits. It is both in the best interests of the investor, and allows members sufficient

time to ensure data quality, report accuracy, quality advisor and investor education material preparation, effective training, and an orderly roll-out to clients of the new reports.

Recommendation: As a result of the significant amount of work required to implement performance and fee/charge reporting, delays in finalizing the CRM2 rules, possible Proposed IIROC CRM2 Amendments, uncertainty regarding the impact of other securities rules on CRM2 development, and mandatory tax and other legislative changes affecting resource availability, we request IIROC to recognize, and to continue to work with CSA and MFDA counterparts on, a five-and-a-half month adjustment to the implementation schedule. As we believe it is recognized that Wednesday, July 15 was a regulatory process choice rather than a date compatible with standard account reporting, permitting the first performance (and fee/charge) report to be for calendar year 2017 is explainable reasonably as it will result in:

- **A better investor experience and outcomes:** Allowing use of calendar 2017 for the first annual performance report permits comparison of two calendar years – 2017 and 2016 (with an at-inception date of January 1, 2016) – using the new market value definition. This will lead to the most fair and reasonable comparison of returns, and promote useful discussion with investors on the purpose of the new reports, importance of comparing returns using periods of consistent length, and decisions that can be made based on the information provided. We know the since-inception return in future will almost never have a full calendar year for the first year an account is open. However, we strongly believe that financial literacy experts and investor advocates would be persuaded that allowing the option of a first performance report using data for January 1-December 31, 2016 and January 1-December 31, 2017 would be much more preferable for investors of varying levels of financial literacy and therefore an option most in the investors' interests for many firms.
- **Materially reduced implementation risk:** A five-and-a-half month adjustment in the implementation schedule would materially reduce the heightened risk of rushing to implement according to an-already-tight timeline made all the more challenging by unexpected changes or delays. To achieve a calendar-year report for 2016, firms would have to speed up to shorten the permitted preparation time by seven and a half months from July 15, 2016 to January 1, 2016. This would not permit the full and proper testing of performance and fee reporting engines and other systems changes that must be tested sequentially and across multiple systems on 2016 data in January of 2017.

2. "Book Cost" Definition

We have set out in previous correspondence the difficulties that major investment industry segments have identified with the existing definition of "book cost". We have discussed CRA's and Revenue Quebec's definition of "cost or book value" sounding like the CSA's and IIROC's "original cost" with a number of professionals in the accounting industry and tax authorities. We continue to work with these individuals in regard to the issue and ways to improve transparency and understanding.

Recommendation: We recommend amendment of the "book cost" definition to the following, with proposed changes underlined:

200.1.(a) "book cost" means:

(i) In the case of a long security position, the total amount paid for the security, including any transaction charges related to the purchase, adjusted for reinvested distributions, returns of capital, and corporate actions ~~reorganizations~~; or

(ii) In the case of a short security position, the total amount received for the security, net of any transaction charges related to the sale, adjusted for any distributions (other than dividends), returns of capital, and corporate actions ~~reorganizations~~; and

(iii) In the case of either a long security position or a short security position, an amount as described in (i) or (ii) that may be adjusted by the Dealer Member to reflect:

(A) legislative or regulatory tax amendments;

(B) the request or consent of the investor according to an election under applicable tax legislation; or

(C) cost information provided by a Delivering Dealer Member or other transferor upon transfer of a security position.

Technical Issues

3. Definition of "Book Cost"

Subsection 200.1(a)(ii) states that book cost "In the case of a short security position, [is] the total amount received for the security, net of any transaction charges related to the sale, adjusted for any distributions other than dividends, returns of capital and corporate reorganizations" *[emphasis added]*. A number of our members found that the punctuation of the sentence was confusing.

Recommendation: For clarity, please add brackets around "other than dividends" to the definition.

4. Definition of "Cost"

We understand that the proposed amendment to subsection 200.1(b) regarding cost, where market value may be cost with the bracketed "as at the [date of transfer]", was drafted to capture the instance of clients in "bulk" account transfer situations. We are concerned that going forward from that date, there could be other transfers into an account and the drafting would necessitate tracking not just by security, but by parts of the same security position, which we know was not intended. Also, once a securities position is transferred in, there are further adjustments made on the basis of reinvested dividends, return of capital and corporate actions, which was not capture by the proposed notice.

Recommendation: Please remove the reference to a specific date in this and any other section requiring date to be tracked as a part of a securities position. As well, please amend the notification that would be included when market value is reported as cost as follows: "Market value ~~as at [date of transfer]~~ has been ~~reported~~ used ~~as the cost of this transferred in~~ to calculate part or all of the cost on this security position." *[amendments in strike-through or underlined]*

Other

5. **Client-name de minimis reporting exemption:** As noted in the notice accompanying the Proposed IIROC CRM2 Amendments, one material change was made at the request of CSA staff. New sub-clause 200.2(e)(i)(B) was included in the Proposed IIROC CRM2 Amendments so that firms with off-book client-name mutual fund positions, where clients receive annual position information from the investment fund manager for their mutual funds, must build the new statement, position cost, performance and compensation reports for off-book clients in addition to for those with nominee holdings, even if the firms would forego compensation on the off-book positions. The IIAC and others did not raise concerns with the original IIROC rule wording by the April 10, 2014 comment due date, as our members have been working to eliminate or reduce to the barest minimum holdings that are not in the more efficient nominee form. The amended rule permits a member to request an exemption from the additional reporting in certain cases.

   A small number of IIAC members have said that they oppose the rule change as exemptions are inappropriate and not in client interests. These firms have a solution, or will be building to support client-name holdings, and see a limited exemption as unfair competition. A number of members are indifferent given their business models. The majority of firms expressing a view will seek an exemption. Of these, for example:

   - One dealer has only 22 client-name accounts – Registered Disability Savings Plans (RDSPs) – and to force these clients to close these accounts (if that were even possible) would either inconvenience or cause unnecessary work for the clients, which is contrary to the aims of CRM2. We are pleased that there are exceptions for certain accounts, such as Registered Education Savings Plans and RDSPs where some positions may only be held in client name.
   - Another small dealer has 269 positions with on average $20,000 in balances. If systems development and implementation expenditure for the additional reporting were $1 million (upfront or amortized), this would mean a cost of approximately $3,700 per account as compared to the $200 on average per year such clients may pay to their dealer. Practically speaking, nominee accountholders would end up bearing the cost to the extent the dealer could not persuade remaining clients to come on book or assist them to move to other dealers.

   As knowledge of the rule change came close to nine months after the December 12, 2013 IIROC rules were published for comment, and four months after the final IIROC comment period closed, any member that will now have to build new systems may not be able to make the stated deadlines, and it will be particularly difficult in light of the calendar-year preference for reporting (see 1. above). We expect that IIROC will provide implementation date relief for any firm that does not receive a requested exemption.

Thank you for considering our comments and please let us know if you have any questions. We appreciate your efforts to help implement CRM2 in a practical and efficient way to allow the best possible investor experience and results.

Yours sincerely,