NI 31-103 FAQ: New rules will affect your client relationships

Professional Development
Realize Your Potential

Q. What is NI 31-103?

A. The full name is National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, and the Canadian Securities Administrators (CSA) have introduced important amendments that started taking effect on July 15, 2013. These amendments are the second phase of the regulators' plan to introduce a new "client relationship model" or CRM, which is why they are referred to as "CRM 2." They will result in a significant change to many advisors' businesses, both positive and negative.

Q. What was the first phase?

A. The first phase required that new clients be given a document that described the relationship between the advisor and client. This is known as the relationship disclosure information or RDI. It also introduced provisions to manage conflict of interest situations. This phase began in March 2012.

Q. What are the CRM 2 requirements?

A. CRM 2 requires that clients receive detailed information on fees and compensation, as well as the performance of their accounts, at specified times. In brief, these include:

- Disclosure, at the time the account is opened, of all account charges and transaction fees charged by the firm.
- Disclosure of all direct and indirect charges associated with the purchase or sale of a security, prior to its purchase or sale. This includes a discussion of, for example, the impact of trailing commissions, and the amount of DSC that may be paid on future redemptions.
- An annual summary of all charges to the client and compensation received by the dealer firm. This would include transaction commissions, trailing commissions and compensation related to debt securities.
- Information about the cost of each security in the account, provided on account statements.
- An annual report of investment performance for each account, which includes the change in value of the account, as well as annualized returns over one, three, five and 10 years and since the account was opened.

Q. When will these changes be implemented?

A. The final set of changes will be in effect as of July 2016. Please see page 4 for more details of the requirements and their implementation dates.

Q. Why are regulators doing this?

A. According to the CSA, its research "shows that many investors currently do not receive this vital information. Providing investors with clear and meaningful information about the costs and performance of their investments will enable them to assess their progress toward their investing goals and the value of professional advice they receive."

Q. What will the client see on the statement regarding fees and compensation?

A. The annual report on charges and other compensation (which can be part of the account statement or a separate document) will show information for the period that includes:

- The firm's current operating charges that apply to the account.
- The total amount of each type of operating charge and transaction charge paid by the client during the period and the total amount of those charges.
- The total commissions from the purchase or sale of debt securities, along with information about any mark-ups, mark-downs, or other service charges.
- The total amount of each type of payment, other than trailing commissions, made to the firm or its individual registrants by another firm in relation to the client, accompanied by an explanation of each type of payment.
- The total amount of trailing commissions received by the firm on the client's account along with disclosure that indicates, among other things, these fees "reduce the amount of the fund's return to you (the client)."

The reporting is on an account-level basis unless the client consents in writing to a consolidated report. A sample report is attached to this FAQ.

Q. Does it specify the portion received by the advisor?

A. No, the report shows the amounts charged or received at the dealer level.

Q. Does it show the amount of the management fee going to the fund company, or the MER of the fund?

A. No. The CSA is relying on the advisor and the Fund Facts to provide this disclosure to investors.

Q. Do these amendments to 31-103 apply to all advice channels?

A. The requirements will apply to anyone selling securities to retail investors in Canada – those registered with the MFDA or IIROC and who conduct business through a registered dealer. This would include the banks, credit unions and investment counsellors and any other registered firm with a direct relationship with retail investors.

Q. Do these rules apply to all investment products, including segregated funds?

A. No. They apply to securities and do not specifically apply to deposit products sold by tellers or insurance products sold by agents, which fall under the aegis of other regulators. However, all assets held with a dealer must be included in the required client statements and reports. In particular, the compensation report must include all charges and compensation received by the dealer related to the account, including commissions, payments and finder's fees from all products.

Before the changes were adopted by the CSA, mutual fund companies argued strongly that these rules, especially in combination with other regulations and initiatives, result in an uneven playing field for mutual funds, which face a much stricter regulatory regime than other products. The CSA responded that they cannot regulate products outside of its jurisdiction but now say they have discussed the issue with other agencies.

Q. What will the performance report show?

A. The information shown in the annual performance report will include:

- Opening and ending market value of all cash and securities in the account for the 12-month period and since inception, as well as the market value of deposits, transfers and withdrawals during the 12 months and since inception, so that the investor can see the dollar amount of the change in value of the account.
- The annualized percentage returns for the one, three, five, 10-year periods and since inception.

A sample report is attached to this FAQ.

Q. Who is responsible for providing the compensation and performance reports?

A. The new disclosure requirements are the responsibility of the dealer. Although mutual fund company disclosure documents such as the Fund Facts provide extensive information about fees and dealer compensation for mutual funds, the new reports will be required over and above those documents. (Investment fund companies are required to provide information about DSC and trailing commissions to the dealer firm. NI 31-103 does not require changes to fund company client statements, except for "orphan" clients – those with no dealer or advisor of record.)

Q. How should I prepare for these changes?

A. We believe that advisors should focus on 1) demonstrating and documenting the value of their advice to clients and 2) preparing to discuss the changes with their clients prior to their implementation. This can be viewed as an opportunity for strong advisors to reinforce the value of their services. Advisors who deliver services in addition to investments – such as financial planning, tax and estate planning, insurance – will be able to present a stronger value proposition.

The Professional Development team's resources on how to prepare and adapt your practice to the new NI 31-103 are available on our website at www.ci.com/pd.

Q. Are the regulators going to change the commission structure, such as banning trailing commissions, which has happened in the U.K. and Australia?

A. The amendments to NI 31-103 do not call for changes to the commission structure for mutual funds. The focus is on ensuring that clients receive comprehensive information about the costs and performance of their investments, with the expectation that advisors will discuss this with their clients.

However, in a paper issued in December 2012 (81-407 *Mutual Fund Fees*), the CSA discussed what they see as potential problems with the current mutual fund fee structure and issued a call for comments on these "topics for consideration":

- Establish a minimum level of service that advisors must provide in exchange for trailing commissions.
- Require every mutual fund to have a low-cost series or class of securities available for direct purchase by "do-it-yourself" investors with no or reduced trailing commission.
- Unbundle the trailing commission from the mutual fund management fee and instead charge and disclose it as a separate asset-based fee.
- Require funds to offer separate series or class of funds for each purchase option (front end, DSC, low load, etc.).
- Set a maximum limit on the portion of mutual fund assets that could be used to pay trailing commissions.
- Implement additional standards or duties for advisors; for example, a legal requirement to put their clients' best interests first (which is already under consideration by the CSA).
- Prohibit the payment to advisors of sales and trailing commissions by mutual fund manufacturers.

As of December 2015, the CSA had not issued any specific proposals to change the commission structure for mutual funds.

NI 31-103 Amendments At A Glance

Here are the highlights of the new requirements and the timeline for their implementation.

July 15, 2013:

- Relationship disclosure information (RDI): it must include a complete description of operating and transaction charges, and a discussion of the costs of investing, particularly the costs of mutual funds.
- New or increased operating charges: 60-day advance written notice to clients required.
- Account statements: they must be provided quarterly; monthly if requested.

July 15, 2014:

- Pre-trade disclosure of charges: registered firms must provide specific disclosure (oral or written) of the charges a client with a non-managed account would have to pay when purchasing or selling a security prior to the firm accepting the client's order. This includes DSC and trailing commissions.
- Benchmarks: firms will be required to provide each client with a general explanation of benchmarks and whether the firm offers any options for benchmark reporting to clients.
- Trade confirmations: Firms must report the annual yield at purchase of a debt security, as well as compensation from debt securities transactions as either: (a) the total dollar amount of compensation or (b) the total dollar amount of any commission paid to the firm and, if the registrant applied a mark-up or mark-down or any service charge other than a commission, provide a general notification.

December 31, 2015:

- Enhanced information on account statements, including:
  - Market value of each security
  - Identification of which securities are subject to redemption charges (DSC) if sold
  - Name of applicable investor protection fund
  - Name of the party that holds or controls each security and a description of how it is held (for client-name accounts)
- Position cost information: Cost of each security position (either book or original cost) must be provided in the account statement or in a separate statement sent at least once every three months.

July 15, 2016:

- Trade confirmations: must include the amount of each transaction charge, DSC or other charges, and the total amount of such charges.
- Report on charges and compensation: clients must be provided with an annual summary of all charges incurred by the client and all other compensation received by the registered firm that relates to the client's account. This includes the nature and amount of compensation received from third parties, such as trailing commissions and certain referral fees.
- Investment performance report: clients must be provided with an annual performance report for their account that includes opening market value, market value of deposits and transfers of cash and securities, and market value of withdrawals and transfers of cash and securities. It must also show annualized returns for the previous one, three and five years, as well as since the account was opened.

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COMPANION POLICY APPENDIX D

[Name of Firm]
Annual Charges and Compensation Report

Client name
Address line 1
Address line 2
Address line 3

Your Account Number: 123456

This report summarizes the compensation that we received directly and indirectly in 20XX. Our compensation comes from two sources:

1. **What we charge you directly. Some of these charges are associated with the operation of your account. Other charges are associated with purchases, sales and other transactions you make in the account.**

2. **What we receive through third parties.**

Charges are important because they reduce your profit or increase your loss from investing. If you need an explanation of the charges described in this report, your representative can help you.

Charges you paid directly to us

RSP administration fee	$100	
Total charges associated with the operation of your account		**$100**
Commissions on purchases of mutual funds with a sales charge	$101	
Switch fees	$45	
Total charges associated with transactions we executed for you		**$146**
Total charges you paid directly to us		**$246**

Compensation we received through third parties

Commissions from mutual fund managers on purchases of mutual funds (see note 1)	$503
Trailing commissions from mutual fund managers (see note 2)	$286
Total compensation we received through third parties	**$789**
Total charges and compensation we received in 20XX	**$1,035**

Notes:

1. When you purchased units of mutual funds on a deferred sales charge basis, we received a commission from the investment fund manager. During the year, these commissions amounted to $503.

2. We received $286 in trailing commissions in respect of securities you owned during the 12-month period covered by this report.

   Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing commission depends on the sales charge option you chose when you purchased the fund. You are not directly charged the trailing commission or the management fee. But, these fees affect you because they reduce the amount of the fund’s return to you. Information about management fees and other charges to your investment funds is included in the prospectus or fund facts document for each fund.

Our current schedule of operating charges

[*As part of the annual report of charges and compensation, registrants are required to provide their current operating charges that may be applicable to their clients’ accounts. For the purposes of this sample document, we are not providing such a list.*]

COMPANION POLICY APPENDIX E

Your investment performance report
Investment account 123456789

For the period ending December 31, 2030

Client name
Address line 1
Address line 2
Address line 3

This report tells you how your account has performed to December 31, 2030. It can help you assess your progress toward meeting your investment goals.

Speak to your representative if you have questions about this report. It is important that you tell your representative if your personal or financial circumstances have changed. Your representative can recommend adjustments to your investments to keep you on track to meeting your goals.

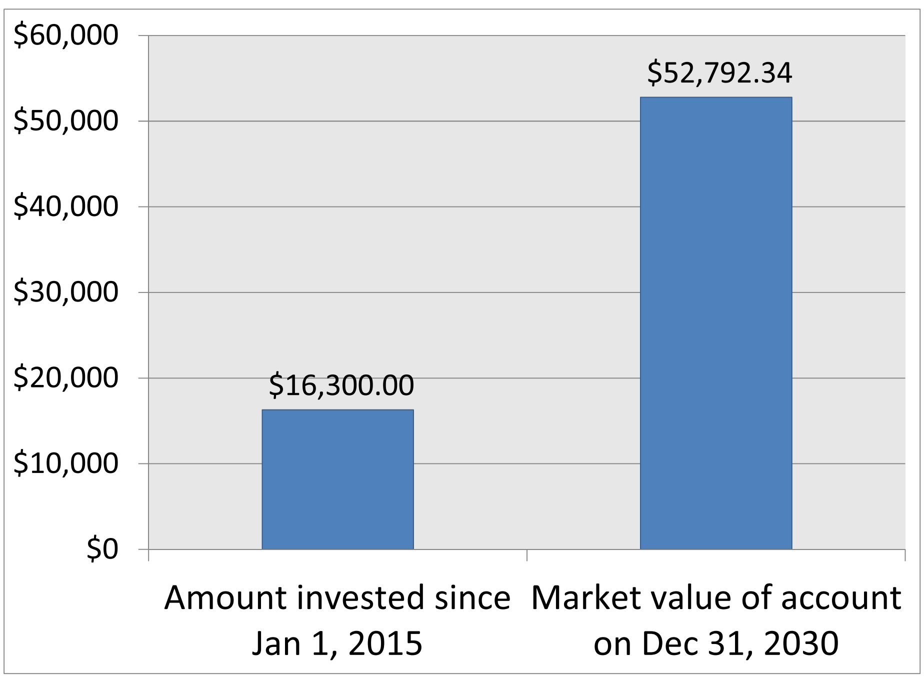
Amount invested means opening market value plus deposits including: the market value of all deposits and transfers of securities and cash into your account, not including interest or dividends reinvested.

Less withdrawals including: the market value of all withdrawals and transfers out of your account.

Total value summary

Your investments have increased by $36,492.34 since you opened the account
Your investments have increased by $2,928.85 during the past year

Amount invested since you opened your account on January 1, 2015	$16,300.00
Market value of your account on December 31, 2030	**$52,792.34**



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Change in the value of your account

This table is a summary of the activity in your account. It shows how the value of your account has changed based on the type of activity.

	Past year	Since you opened your account
Opening market value	$51,063.49	$0.00
Deposits	$4,000.00	$21,500.00
Withdrawals	$(5,200.00)	$(5,200.00)
Change in the market value of your account	$2,928.85	$36,492.34
Closing market value	**$52,792.34**	**$52,792.34**

Your personal rates of return

What is a total percentage return?
This represents gains and losses of an investment over a specified period of time, including realized and unrealized capital gains and losses plus income, expressed as a percentage.

For example, an annual total percentage return of 5% for the past three years means that the investment effectively grew by 5% a year in each of the three years.

The table below shows the total percentage return of your account for periods ending December 31, 2030. Returns are calculated after charges have been deducted. These include charges you pay for advice, transaction charges and account-related charges, but not income tax.

Keep in mind your returns reflect the mix of investments and risk level of your account. When assessing your returns, consider your investment goals, the amount of risk you're comfortable with, and the value of the advice and services you receive.

	Past year	Past 3 years	Past 5 years	Past 10 years	Since you opened your account
Your account	5.51%	10.92%	12.07%	12.90%	13.09%

Calculation method
We use a money weighted method to calculate rates of return. Contact your representative if you want more information about this calculation.

The returns in this table are your personal rates of return. Your returns are affected by changes in the value of the securities you have invested in, dividends and interest that they paid, and also deposits and withdrawals to and from your account.

If you have a personal financial plan, it will contain a target rate of return, which is the return required to achieve your investment objectives. By comparing the rates of return you actually achieved (shown in the table) with your target rate of return, you can see whether you are on track to meet your investment objectives.

Contact your representative to discuss your rate of return and investment objectives.