

IIROC NOTICE

Rules Notice Guidance Note

Dealer Member Rules

Please distribute internally to:

Legal and Compliance

Operations

Retail

Senior Management

Training

Contact:

Darshna Amin
Senior Policy Counsel, Member Regulation Policy
416-943-5891
damin@iiroc.ca

18-0242

December 20, 2018

Service arrangements between Dealer Members and Portfolio Managers

This Notice provides guidance to Dealer Members on best practices when entering into Portfolio Manager – Dealer Member Service Arrangements (**PMDSA**) with registered portfolio managers.

The Canadian Securities Administrators (**CSA**) [Staff Notice 31-347](#) *Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members* (dated November 17, 2016) (**CSA Notice**) provides additional information on acceptable practices under these arrangements primarily to help portfolio managers comply with their regulatory obligations under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**).



Contents

1. Structure of PMDSAs.....	3
2. Purpose and Scope.....	3
3. IIROC Requirements.....	4
3.1 Written agreement between the Dealer and PM.....	4
3.2 Account opening.....	5
3.2.1 Account opening and operation.....	5
3.2.2 Disclosure to clients.....	6
3.3 Account information provided to clients.....	7
3.3.1 Trade confirmations.....	7
3.3.2 Account statements.....	7
3.3.3 Performance report and fee/charge report.....	8
3.4 Policies and procedures for PMDSAs.....	9
3.5 Termination of the relationship between the PM and the client.....	9
4. Questions.....	9
5. Applicable Rules.....	10



1. Structure of PMDSAs

Under a PMDSA, a Dealer Member will hold an investor's cash and/or securities in an account over which a registered portfolio manager (**PM**) has discretionary trading authority. The Dealer Member (**Dealer**) will execute, clear, and/or settle the investor's trades and positions in the account based on instructions it receives from the PM. The investor is considered to be a client of both the PM and the Dealer but, each has different roles and responsibilities, and different regulatory obligations, to the client.

Generally, PMDSAs operate as follows:

- An investor will enter into an investment management agreement with the PM that provides the PM with discretionary trading authority to manage its investments, and so becomes a client of the PM.
- The PM collects the know-your-client information in order to conduct a suitability assessment.
- The PM facilitates opening a trading account in the name of the client at the Dealer. The PM will provide the client with the Dealer's account application to complete and collect all relevant client account records required by the Dealer to open an account. The PM will provide this information to the Dealer. After the Dealer's designated Supervisor reviews and approves the new account, the PM client then also becomes the Dealer's client.
- The Dealer will execute, clear and/or settle trades for the client based on the trading instructions it receives from the PM, and the Dealer will custody the client's investments.
- The Dealer does not provide any trade recommendations to the client or perform any suitability assessments.

2. Purpose and Scope

The intent of this guidance is to help Dealers that enter into PMDSAs to understand their regulatory obligations under IIROC requirements.

This guidance covers PMDSAs where client investments are held at the Dealer on a fully disclosed basis; that is, a separate trading account for each client of the PM is opened in the client's name at the Dealer.

This guidance does not apply where client investments are held on an undisclosed basis under an omnibus arrangement in the limited circumstances permitted under securities laws¹; that is,

¹ Please refer to section 14.5.3 of NI 31-103.



investments of multiple clients of the PM are amalgamated and held in an account opened in the name of the PM only.

Also, this guidance does not cover other service arrangements between a PM and Dealer such as:

- prime-brokerage services
- sub-advisor arrangements
- referral arrangements.

Although there are no regulatory requirements specifically governing PMDSAs, there are several IIROC requirements that affect these arrangements². We discuss some of these below but, this guidance is not an exhaustive list of all the IIROC requirements applicable to a Dealer's business activities.

3. IIROC Requirements

3.1 Written agreement between the Dealer and PM

We expect Dealers to execute a written agreement with the PM that accurately explains the arrangement and clearly defines the roles and responsibilities of each party under the arrangement³. This agreement should address⁴:

- the services, responsibilities and obligations the Dealer will provide to each of the PM and the client
- the services, responsibilities and obligations the PM will provide to each of the Dealer and the client
- the fees that will be charged by the Dealer to the PM and/or the client for the arrangement
- termination provisions that address events such as PM insolvency, PM surrender of registration, and mergers.

Where a Dealer is considering executing a standard agreement provided by a PM, the Dealer should closely review the provisions of the agreement to ensure it thoroughly addresses the above key elements.

² To assist readers, we have included footnotes in this guidance referencing the applicable Dealer Member Rule (**DMR**) and Plain Language Rule (**PLR**) provisions. Since the PLR is not yet effective, we have included the PLR reference in square brackets. When PLR becomes effective, we will update this guidance referencing only the PLR provisions.

³ DMR 17.2 and 200.1 [PLR subsection 3804(1)]

⁴ The Investment Industry Association of Canada has developed a template agreement ("Portfolio Manager – IIROC Dealer Services Agreement") for use by Dealers.



3.2 Account opening

Under a PMDSA, the Dealer is responsible for opening an account in the client's name and ensuring the PM has trading authority on the account. These client accounts must be identifiable in the Dealer's books and records by setting up the clients either in a separate account range or with unique account identifiers.

3.2.1 Account opening and operation.

The Dealer is responsible for:

- reviewing the client's identification information⁵ and other account opening documents received from the PM that the Dealer requires to open an account (including account agreements, client's acknowledgement of receipt of disclosures, trading authorization).⁶
- maintaining accurate, complete and up-to-date client account records (including any agreements with the client, disclosures provided to the client, or any fee schedule), and revising that information where there are material changes⁷
- in the case of institutional clients, verifying that the client qualifies as an institutional client⁸
- where the client opens a margin account or uses leverage to trade, verifying that they are aware of the risk of trading on margin and providing each client with a leverage disclosure statement where applicable⁹
- complying with best execution obligations for all client orders¹⁰
- reporting information on any debt securities transactions directly to IIROC¹¹
- monitoring and supervising client accounts (including daily and monthly supervision of trading activity, taking reasonable steps to identify any existing or potential material conflicts of interest between the Dealer and the client, complying with requirements under anti-money-laundering and terrorist-financing legislation and regulations)¹²
- maintaining records of business activities, client transactions, and communications with the PM and client in accordance with IIROC requirements (including maintaining an audit trail of instructions and orders received from the PM acting on

⁵ A Dealer may appoint the PM as its agent for client identification requirements in accordance with anti-money laundering and terrorist financing legislation and regulations.

⁶ DMR 1300.1(a) and 2500.II.A.1 [PLR sections 3103, 3202 and 3212]

⁷ DMR 2500.II.A.4 and 2500.II.A.5 [PLR sections 3212 and 3213]

⁸ DMR 1300.2 [PLR section 3212]

⁹ DMR 200.2 and Guide to Interpretation (m) and DMR 29.26 [PLR sections 3217, 3246 and 3247]

¹⁰ DMR 3300 [PLR sections 3120 and 3503]

¹¹ DRM 2800C [PLR section 7200]

¹² DMR 1300, 2500, and 2700 [PLR section 3900]



- behalf of the client and each trade transmitted or executed for a client, identification and segregation of client cash and securities, and monthly or quarterly account statements sent to the client)¹³
- ensuring that any assets of the client that the Dealer custodies are appropriately segregated and protected in accordance with IIROC requirements (including securities held in safekeeping)¹⁴

The Dealer is not responsible for performing a suitability assessment for the purchase, sale, hold, exchange or transfer of positions held in a client account¹⁵.

3.2.2 Disclosure to clients

The Dealer must provide the client relationship disclosure information (**RDI**) as required under DMR 3500. As part of the Dealer's RDI obligations, where a client has an account that is the subject of a PMDSA, the written disclosure must clearly explain:

- the purpose and material terms of the PMDSA
- the key services provided by the Dealer to the client
- the key responsibilities and obligations of the Dealer to the client
- that the PM has sole responsibility for the suitability of account holdings
- that only the PM is authorized to conduct trades in the account and perform any other actions that will alter the nature of the account holdings
- how the compensation arrangement under the PMDSA relates to the client account.

We expect the Dealer to customize the RDI to reflect the arrangement between the Dealer and the client. A Dealer may provide an RDI to the client directly or, to ensure the client receives consistent, complete and accurate information, the Dealer and PM may prepare a joint RDI that includes a discussion of the services provided by the PM and the responsibilities and obligations of the PM¹⁶. We encourage you to discuss the use of a joint disclosure statement with us prior to proceeding in this way.

The Dealer must provide the RDI to the client at the time of account opening.¹⁷ If there are any material changes to the RDI after the account is opened, the Dealer must notify the client of the changes in a timely manner.¹⁸

¹³ DMR 200.2 [PLR section 3804]

¹⁴ DMR 2000 and 2600 [PLR sections 4300 and 4400]

¹⁵ DMR 1300.1(u) [PLR 3404(2)]

¹⁶ The Dealer must ensure it complies with IIROC's delivery requirements for RDI.

¹⁷ DMR 3500 [PLR section 3216]

¹⁸ DMR 3500 [PLR section 3216]



3.3 Account information provided to clients

3.3.1 Trade confirmations

A Dealer must promptly send trade confirmations to the client for all investments purchased or sold based on the trading instructions received from the PM unless the client provides written authorization to send the trade confirmations to the PM only.¹⁹ We expect Dealers to retain an adequate record of each order and instruction received from the PM for a client account.

3.3.2 Account statements

Since the Dealer is responsible for the custody of the client's investments, the Dealer must send the client a monthly account statement (or quarterly, if applicable).²⁰ A Dealer must apply to IIROC for an exemption if it wishes to deliver account statements in accordance with the frequency requirements applicable to PM's under section 14.14.1(3) of NI 31-103.

Where the client has more than one account, the Dealer must provide a separate statement for each account. The account information for multiple accounts cannot be combined into a single summary statement as if it was one account or portfolio. For delivery of account statements to a client, each account statement may be included in one document or package. However, a Dealer may provide a consolidated account statement, in addition to the separate account statements, if the client requests this information to better understand their overall investment portfolio.

The account statements should be branded in the Dealer's name only and include all necessary disclosures, including the Canadian Investor Protection Fund ("CIPF") disclosure.²¹

Specifically for PMDSA's, the Dealer should place the following CIPF disclosure prominently on the front page of the account statement:

This statement is being issued to you by [Dealer Member name]. [Dealer Member name] has agreed to act as the custodian for the assets disclosed on this statement. The assets that may be eligible for CIPF coverage, within specified limits, are limited to those disclosed in this account statement.

¹⁹ DMR 200.2(l) [PLR section 3816]

²⁰ DMR 200.2(d) [PLR section 3808]

²¹ DMR 700.1, 29.7A and 29.28 [PLR sections 2354, 2355 and 2356] and the IIROC Membership Disclosure Policy



In addition, Dealers may modify the CIPF Explanatory Statement that is required to be included on all account statements as follows: *“Customers’ accounts at IIROC Dealer Members are protected by the Canadian Investor Protection Fund within specified limits. A brochure describing the nature and limits of coverage is available [[upon request] or [upon request or at www.cipf.ca]]”*²²

Where the Dealer plans to include the PM’s contact information as well on the client account statement, it should appear on the statement as follows:

Portfolio Manager contact information:

- [Individual representative name and contact details]
- [Firm name and contact details]

However, the Dealer should not place the PM’s contact information:

- near the IIROC logo or CIPF logo (i.e. directly above, below or beside it), or
- in a manner that suggests or implies that CIPF coverage applies to losses arising from the insolvency of a PM.

3.3.3 Performance report and fee/charge report

The Dealer is required to provide an annual performance report to the client²³. Where a Dealer enters into a PMDSA and the PM is providing the performance report in accordance with section 14.18 of NI 31-103, the Dealer may consider applying to IIROC for an exemption from this requirement.

Similarly, the Dealer must provide an annual fee/charge report to the client where it is responsible for collecting fees, charges or other payments, directly or indirectly, from the client²⁴, unless the arrangement meets the requirements of Notice 16-0113.²⁵ Where the compensation arrangements associated with a PMDSA are complex, explanatory notes or reminders must be provided on the annual fee/charge report, to help clients understand how the fees associated with the PMDSA apply to their account.

²² DMR 29.28 [section 2355 of the IIROC rules] and CIPF Disclosure Policy

²³ DMR 200.2(f) [PLR section 3810]

²⁴ DMR 200.2(g) [PLR section 3811]

²⁵ FAQ #27 of Notice 16-0113



3.4 Policies and procedures for PMDSAs

Dealers are required to have policies and procedures addressing their business activities and operations, including for PMDSAs, which are designed to ensure compliance with IIROC requirements and applicable laws.²⁶

Dealers' policies and procedures for PMDSAs should at a minimum:

- ensure the client has a clear understanding of the purpose of the PMDSA and the key services, responsibilities and obligations of the Dealer and the PM to the client
- address how proxy material, shareholder information, and corporate action notifications will be communicated to the PM, and how the PM's or client's instructions will be processed
- establish an efficient process for handling and resolving client complaints in relation to services provided under the PMDSA
- establish a process for expeditiously resolving any account statement discrepancies in relation to services provided under the PMDSA
- ensure the PM will provide information to and assist the Dealer in the event of an IIROC investigation or an investigation by a marketplace²⁷.

3.5 Termination of the relationship between the PM and the client

If the relationship between the client and the PM terminates for any reason, the Dealer must restrict the client's accounts to paying out funds, delivering securities or transferring out positions. The Dealer will continue to custody the clients' assets but cannot conduct any transactions for the client. If the client wishes to maintain a trading relationship with the Dealer, the Dealer must open a new account for the client and follow the new account opening process.

4. Questions

For more information, please contact the Financial and Operations Compliance and/or Business Conduct Compliance relationship manager assigned to your firm.

²⁶ DMR 38.1(i) [PLR section 3904]

²⁷ As defined in IIROC General By-law No.1, Section 1.1.



5. Applicable Rules

This guidance note relates to the following DMRs:

- 29.28
- 38.1
- 200
- 200.1
- 200.2(d), (f), (g) and (l)
- 700.1
- 1300.1
- 2500.II
- 2600
- 2700.I
- 3300
- 3500