

Legal update

OSC releases guidance for PMs regarding service arrangements with IIROC dealer members

November 2016

Asset and wealth management

On November 17th, the Canadian Securities Administrators (CSA) issued Staff Notice 31-347 (the Notice), which provides information and guidance to portfolio managers (PMs) that enter into Portfolio Manager–Dealer Member Service Arrangements (PMDSAs) with dealer members (DMs) of IIROC. Under these PMDSAs, a DM holds an investor's cash and securities (Investments) in an account over which a PM has discretionary trading authority, and executes and settles the investor's trades in the account based on instructions from the PM. The investor is thus a client of both the PM and DM.

The Notice states that PMDSAs can be beneficial for investors and may be entered into by PMs provided all obligations under *National Instrument 31-103 - Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) are met. Certain of these obligations are summarized below.

Books and records

It is not permissible for a PM operating with a PMDSA to rely entirely on a DM's records as a substitute for the PM maintaining its own books and records for its clients' Investment positions and trades within the PMDSA. While a PM may outsource elements of the compilation of books and records to an agent, the PM is responsible for verifying the completeness and accuracy of the information and maintaining it in an accessible form. As part of maintaining its own books and records of its clients' Investment positions and trades, a PM may use information provided from third parties, including DMs, provided the PM takes active steps to ensure the information is complete and accurate (for example, by reviewing and reconciling the information against its other records, such as clients' trade orders and trade confirmations).

Simply downloading information from a DM's system to its own books and records system is not acceptable, as the PM is responsible for ensuring its records are complete and accurate. Further, should a PM use information from DMs when producing a client statement, it is not acceptable to include a disclaimer as to the completeness or accuracy of the information in the statement as the PM is solely responsible for the content of the documents it is required to deliver to clients under NI 31-103.

Written agreements

All PMs that enter into PMDSAs must have executed, written agreements with their DM counterparts. At a minimum, the written agreement should contain the PMDSA's key terms, including the PM and DM's roles and responsibilities.

Statements of investment positions and trades (Statements)

The Notice provides that a PM operating with a PMDSA can satisfy its obligation to deliver Statements to a client when that client's DM, acting as custodian, sends a Statement to the client (for each of the client's accounts at the DM), provided the PM takes a number of steps that are enumerated in the Notice, including (i) verifying that Statements containing the required content are delivered to the client by the DM at the required frequency and (ii) taking reasonable steps to verify that the content of the Statements issued to its clients is complete and accurate, including by regularly reconciling its books and records of client Investment positions and trades against the DM's records, and maintaining evidence of the reconciliations.

If a PM decides to satisfy its Statement obligations by relying on Statements issued by a DM, then the CSA expects the PM to establish reasonable written policies and procedures so it can demonstrate to CSA staff how it is meeting its obligations.

Note that if a PM holds any Investments for a client, or has trading authority over any of the client's Investments that are not held in the client's account at a DM, then the PM may not rely on the Statement issued by a DM to satisfy its Statement delivery obligations for that client. In these cases, the PM must issue its own Statements covering all of the client's Investments that it holds or has trading authority over.

Note as well that while a PM can rely on the Statements issued by a DM to satisfy the PM's obligation to issue Statements (subject to the preceding paragraph and provided the steps enumerated in the Notice are followed), a PM's obligation to issue to its clients an annual report on charges and other compensation and an annual investment performance report must be issued by the PM under the PM firm's name.

Client disclosure

PMs must provide each of their clients served under a PMDSA with written disclosure that clearly and concisely explains the arrangement, including details on (i) the purpose and material terms of the PMDSA, (ii) the key services provided by the PM and DM to the client, and (iii) the key obligations owed by the PM and DM to the client. Additional disclosure is required where a PM will rely on Statements issued by the DM to satisfy the PM's obligation to issue Statements.

The CSA expects this disclosure to be provided to each client before the PM–client relationship begins. When there are any material changes to the PMDSA, the CSA expects the PM to revise the disclosure and notify the client of the changes in a timely manner. For clients subject to existing PMDSAs, the CSA expects that PMs will take steps to provide this disclosure to their clients in a timely manner (for example, within one year of the Notice's publication date), either separately or as part of another communication to clients.

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