ANNEX B

Summary of Comments and Responses on the 2012 Proposal

This Annex summarizes the public comments we received on the 2012 Proposal and our responses to those comments.

Categories of comments and single response

In this document, we have consolidated and summarized the comments and our responses by the general theme of the comments. In general, we have not included comments already addressed in our responses to comments on the proposal published on June 22, 2011 (the 2011 Proposal).

Contents of this summary

This summary is organized into the following sections:

1. Costs and benefits
2. Fairness / Unlevel playing field
3. Harmonization
4. Trailing commission disclosure
5. Switch or change transactions
6. Foreign exchange rate
7. Foreign exchange spread
8. Client statements
9. Definition of “client” and “account”
10. Market valuation methodology
11. Position cost
12. Report on charges and other compensation
13. Fixed-income securities
14. Primary distributions
15. Percentage return calculation method

16. Scholarship plan dealers

17. Benchmarks

18. Transition

19. List of commenters

In this annex, we reference the sections and paragraphs of the Rule provided in Annex C except where otherwise indicated.

Summary of comments and responses

1. Costs and benefits

There were a variety of comments to the effect that we should have conducted a quantitative cost benefit analysis (CBA) before making our proposals. Most of these comments focused on the proposal to require disclosure of the dollar amount of trailing commissions paid to a registered firm.

A quantitative CBA is not a prerequisite for rule-making.

We have made a qualitative assessment of the costs and benefits of requiring dollar disclosure of trailing commissions based on research as to what investors understand about trailing commissions. A large proportion of retail clients are either unaware of trailing commissions or have a very limited understanding of them. At the same time, trailing commissions are the dominant form of compensation for selling mutual funds today. It is therefore essential that clients be provided with direct, client-specific information about the amount of trailing commissions paid in respect of their investments.

Information about the costs of goods and services and a seller's incentives is fundamental. As such, we regard providing that information as a cost of doing business and not something that should be passed on to clients.

We think the same analysis applies in respect of comprehensive reporting on the securities a client has purchased or sold through a registrant, and in respect of investment performance reporting.

We acknowledge that there will be one-time system building costs associated with the new reporting requirements. We have provided unusually long transition periods for some of the new requirements in order to ensure there is sufficient time for the building and implementation of these systems. We note that regardless of the requirement to report trailing commissions, registered dealers and advisers would in any event be required to build systems to provide the new annual report on charges and other compensation. We do not think the costs of including

trailing commission information in the annual report will be significant after the necessary systems have been built.

It is also worth noting that other CSA initiatives are providing registered firms, particularly those in the mutual fund industry, with opportunities for reductions in ongoing costs. These include the availability of electronic delivery options as an alternative to printing and mailing, and plans for the replacement of the mutual fund prospectus with the Fund Facts document.

2. Fairness / Unlevel playing field

We received comments from the mutual fund industry, similar to those made on the 2011 Proposal, that the 2012 Proposal would result in an uneven playing field for registered firms, as investment products that do not fall under the jurisdiction of the CSA will not be subject to comparable cost disclosure and performance reporting. We reiterate that we can only make rules within our jurisdiction. The fact that other segments of the financial industry will not have comparable requirements for non-securities investments is not a reason to reduce the level of disclosure that we think is necessary for those who invest in securities.

Several commenters called for the CSA to work with other financial regulators, departments of finance and other government departments and agencies to promote a level playing field for all sellers of various investment products. We acknowledge that it would be in the interest of investors if comparable cost and performance transparency could be achieved for all investment products. CSA members are communicating with other financial regulators and government departments and agencies to raise this issue.

There were also some comments suggesting that investors will be misled about the relative costs of alternative investments compared to securities. Other commenters asserted this might lead some registrants to recommend alternative investments over securities. We would remind such registrants that they can explain the costs associated with various investment products and they have the duty to act fairly, honestly and in good faith toward clients.

3. Harmonization

We received comments concerning the importance of harmonizing the Instrument with member rules of the securities industry self-regulatory organizations (SROs), which are the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA).

We made revisions to the 2012 Proposal in several ways to be more closely harmonized with SRO requirements including:

- changing the trade confirmation requirements for debt securities to more closely resemble the approach taken in current IIROC requirements

- breaking the proposed “client statement” into constituent elements of account statement, additional statement and position cost information, rather than requiring their consolidation and delivery as a single document

- allowing the use of original cost for position cost information

- providing exemptions for permitted clients that are not individuals from the position cost information requirement (IIROC exempts “Institutional Customers”, which is a similar but not identical category)

We continue to work with the SROs to ensure that their member requirements will be materially harmonized with the common baseline for registrants set out in the Instrument.

4. Trailing commission disclosure

Many mutual fund industry members continued to express their opposition to the requirement for disclosure of dollar amounts of trailing commissions. We have considered these comments again and disagree for the reasons set out above under “Costs and benefits”.

We received comments suggesting that mutual fund companies with in-house distribution might change their distribution compensation system to eliminate trailing commissions, making other mutual fund dealers, who continue to rely on trailing commissions, seem more costly to investors. The CSA objective is to make disclosure of key information more transparent and by doing so, we are neither supporting nor discouraging the use of trailing commissions by making disclosure better. If problems emerge in other compensation models we will consider appropriate action.

Some commenters suggested that investors might think the trailing commission is charged on top of the management fee of a product. We have revised the notification to make it clear that trailing commissions do not represent an additional cost to investors. We have also revised the Companion Policy to remind registered firms and their representatives that they can explain their compensation model in more detail in disclosure documents or in face-to face meetings with their clients.

We have revised the definition of “trailing commission” in section 1.1 of the Rule to be more technically accurate.

We received requests for more specific requirements with respect to investment fund managers’ obligation under subsection 14.1.1 to provide dealers and advisers with information concerning charges deducted from the net asset value of securities upon their redemption and trailing commissions in order for dealers and advisers selling their products to be able to meet client reporting obligations. This is a principles based requirement. The substance of the dealers’ and advisers’ obligation is clearly set out in paragraphs 14.12(1)(c) and 14.17(1)(h). Investment fund managers and the dealers and advisers who sell their products will have to work cooperatively with one another and, in many cases, with FundServ or other service providers. The systems work necessary for different investment fund managers to ensure the distributors of their

products will be able to satisfy their client reporting obligations will vary. Some of what is needed might only become apparent to information technology specialists during the course of developing the new systems. We will work with industry to respond pragmatically to any needs for guidance that may emerge as this process progresses.

We have provided a transition period of three years in order for investment fund managers, dealers and advisers to have sufficient time to build and test reporting systems to comply with the new requirements. We expect investment fund managers, dealers and advisers to be fully compliant at the end of the three year transition period, so that trade confirmations will include the new information about various charges immediately after the transition period ends and the new information will be included in clients' reports on charges and other compensation for the period that includes the first day after the end of the transition period.

5. Switch or change transactions

We received comments that the proposed language in section 14.2.1 of the Companion Policy regarding switch transactions is misleading and highlights practices that are not problematic, while ignoring other practices that might be. Some commenters added that the proposed language does not belong in the Companion Policy but rather in SRO rules.

We have clarified the language in the Companion Policy. We consider clear and complete disclosure of all charges, incentives and implications associated with a switch or change transaction is necessary given that mutual fund compensation structures are not clearly understood by many investors. We regard it as a fundamental issue linked to a registrant's duty to act fairly, honestly and in good faith. We have kept the language, as clarified, in the Companion Policy as not all registered dealers are required to be members of an SRO.

6. Foreign exchange rate

One comment letter suggested that the foreign exchange rate used in calculating the market value of non-Canadian dollar denominated securities should be indicated on statements. We consider this disclosure to be a best practice and we have revised the Companion Policy to encourage registrants to disclose the foreign exchange rate on account or additional statements.

7. Foreign exchange spread

We have dropped foreign exchange spreads from the examples of "transaction charges" that were included in the Companion Policy guidance under the 2012 Proposal. We accept the comments to the effect that it is often not possible to provide the exact amount of foreign exchange spreads on a transaction-by-transaction basis, and that calculating an approximate dollar spread would be complicated and costly, with results that would not always be accurate. We have added to the Companion Policy a statement that although we do not consider foreign exchange spreads to be a transaction charge, we encourage registered firms to include a general notification in trade confirmations and reports on charges and other compensation that the firm may have incurred a gain or loss from a foreign exchange transaction as a best practice.

8. Client statements

We received comments that, since investment funds managers already send security holder statements directly to investors, it will be duplicative and confusing if the dealer or adviser provides the same information to their clients. When delivering statements to their security holders, except for those statements delivered under section 14.15, investment fund managers are not complying with any regulatory requirement. We think that it is entirely appropriate that the responsibility to report to a client be that of their dealer or adviser and not fragmented among the fund families in which the client may have invested.

We disagree with comments that information on securities not held or controlled by a dealer or adviser that the 2012 Proposals would have included in a "client statement" would be unreliable. We have limited the new requirement to securities that a registered firm can reliably verify its clients continue to own. The requirements to include these securities in the new additional statement and in the new performance report, and to provide a position cost for them, will apply two years and three years, respectively, after the Amendments come into force. There is no requirement to gather information relating to earlier periods. For performance reports and position cost information, we provide that market value can be used to establish the initial valuation as of the implementation date.

We received some comments that the delivery of current account statements would be delayed by integrating it with the required new information in the proposed client statement because the new information will have to come from external sources. We agree with the comments and have revised our proposal to allow registered firms to provide the new information to clients separately from the current account statement, at their discretion. We will require the new information about client name securities to be delivered at least quarterly, and within not more than 10 days of the delivery of the account statement.

We encourage firms to work to the point where they will have systems that will enable the new statements to be produced in a timely manner or the two documents to be sent together.

9. Definition of "client" and "account"

We disagree with comments that requested we include in the Rule a definition of the terms "client" and "account" in order to clarify who and how the disclosure and reporting should be provided. The terms "client" and "account" are common terms that are used often and repeatedly throughout securities legislation and rules. Our intent in using those terms in the 2012 Proposal in the context of cost disclosure and performance reporting is the plain language meaning.

10. Market valuation methodology

We received some comment letters that suggested the proposed market valuation methodology is not consistent with the Canadian Generally Accepted Accounting Principles (GAAP), and is overly prescriptive as compared to International Financial Reporting Standards (IFRS). It was also suggested that the methodology used be consistent with Canadian GAAP in order to reflect the approach taken in the Instrument in respect of working capital calculation and financial

reporting and section 2.6 of National Instrument 81-106 *Investment Fund Continuous Disclosure*.

We have prescribed a hierarchy of valuation methods that we think is a reasonable approach to ensuring that the market values of securities being reported to investors are reflective of their current values. We are addressing market value determination only for the specific purpose of client reporting. While the prescribed approach does include concepts from IFRS, it also takes into account that reporting an accounting valuation of a security for which no market exists may be misleading for investors.

Some comment letters expressed concern that the use of last bid price for long positions and last ask price for short positions as market value is inappropriate, overly prescriptive and not in accordance with Canadian GAAP. One specific concern was that these values may be misleading to clients as there could be large bid/ask deviations that do not reflect the market value of the security. Several comment letters suggested that the current last trade calculation is a simpler, established and more appropriate methodology for valuing securities for the purpose of client reporting.

We acknowledge that there are practical issues with the use of last bid/ask price, and that it may not always result in a market value that is reflective of the current value of a security. However, the methodology that we have prescribed is currently in use by some registrants and allows for adjustment to the last bid/ask price should a registered firm deem it necessary to accurately reflect the current value of the security. We expect registrants to exercise professional judgement in applying the methodology and take heed of the requirement that market values should be reflective of the current value of a security at the date of client reporting.

11. Position cost

We received several comment letters in support of book cost as the appropriate method for presenting position cost, as set out in the 2012 Proposals. A number of other commenters advocated the use of original cost, and several others were in favour of allowing registered firms the flexibility to choose between presenting original cost and book cost.

We have concluded that neither method for determining position cost is clearly more beneficial to investors than the other. Consequently, we do not think it would be appropriate to mandate one as the only acceptable method.

12. Report on charges and other compensation

In response to comments concerning the scope of the part of the 2012 Proposals that is now addressed in paragraph 14.17(1)(g), we have clarified that the only referral arrangements that must be included in the annual report on charges and other compensation are those made to the registered firm or any of its registered individuals by a securities issuer or another registrant in relation to registerable services to the client during the period covered by the report.

We were asked by one commenter whether portfolio managers who manage their clients' money through pooled funds would be required to look through the pooled fund to determine how much of the pooled funds' management fee related to units held by its clients. The definition of operating charge is specific to the account and is not a product related fee so the portfolio manager would not be required to include a fund management fee in the report on charges and other compensation that it delivers to a client. However, if a portfolio manager's compensation model is one that relies on fund management fees rather than the more usual portfolio management fee, we would expect the portfolio manager to ensure that its clients fully understand the basis on which the firm is compensated for its advising services and report those charges to its clients on an annual basis, in keeping with the duty to deal with clients fairly, honestly and in good faith.

One commenter proposed an exemption from the requirement to provide clients with an annual report on charges or other compensation for employee programs which offer a firm's proprietary funds to employees through an ongoing compensation program. We think relief may be appropriate in limited circumstances, such as where all of the employees in the plan already have knowledge of or ready access to the relevant information relating to the performance of the pooled funds. However, we do not believe this will always be the case for employee programs involving proprietary funds. We will therefore consider exemptions on the basis of discretionary relief applications.

13. Fixed-income securities

In response to our request for comments on the feasibility of requiring disclosure of all of the compensation and/or income earned by registered firms from fixed-income transactions, we received comments from industry that such disclosure would not be feasible or appropriate. Other commenters said that this information would be desirable.

At the same time, a number of commenters submitted that the so-called gross (retail) commission paid to dealer firms is readily available information. Commenters also argued that the disclosure of the dollar amount of compensation paid to a dealing representative required under our 2012 Proposal could be misleading to retail clients because it may represent only a percentage of the commission received by the dealer firm on a fixed-income transaction. We agree and have revised the requirement accordingly to require disclosure at the firm level. This approach is also consistent with the new requirement for trailing commission disclosure.

The revised requirement provides registrants the following two options. Registrants may disclose the total dollar amount of its compensation taken on the trade (which may consist of any mark-up or mark-down, commission or other service charge) or, alternatively, the total dollar amount of commission, if any, and if the registrant applied a mark-up or mark-down or any service charge other than a commission, a prescribed general notification.

The revised requirement, including the prescribed general notification, is substantially harmonized with IIROC's equivalent requirement, except that it adds the requirement to disclose commissions if a firm does not opt to provide the total dollar amount of compensation.

Some commenters requested that we provide a definition of fixed-income security and clarify the types of products which would not be considered fixed-income securities. We have clarified the Rule by replacing "fixed-income securities" with "debt securities", a defined term under securities legislation.

14. Primary distributions

There were comments concerning the extent to which payments to dealers or advisers in respect of equity initial offerings or primary offerings of fixed income securities might be included in the new requirements for trade confirmations and reports on charges and other compensation.

One-time payments to a registered dealer or registered adviser in connection with an initial distribution of securities from an issuer or other party other than an investor who is a client of the dealer or adviser may relate to services other than services the dealer or adviser provides to the client. For example, an issuer might pay for investment banking service. We have drafted sections 14.12 and 14.17 and the relevant definitions to ensure that payments of this kind would not be required to be disclosed to a client. On the other hand, commissions charged to a client or ongoing payments in relation to the client's investments within definition of trailing commission would be required to be disclosed to the client.

15. Percentage return calculation method

We received many comments concerning the percentage return calculation methodology. The majority of commenters recommended allowing registered firms to determine the most appropriate calculation methodology for performance reporting, while a number of commenters were in favour of mandating the money weighted rate of return (MWRR) methodology (also known as the dollar weighted methodology), as set out in the 2012 Proposal. Some of the commenters would prefer the time weighted rate of return (TWRR) method, should we mandate the use of one particular methodology. A small number of commenters argued performance reports should include percentage returns based on both methodologies.

We have decided to require the use of the MWRR method because we have concluded that it is the better choice for investors. This project aims to provide performance information that is useful to a client as a measure of their progress toward their investing goals. Research points strongly toward the value of measures that retail investors can relate directly to their own experience. We think all investors share an interest in performance figures that focus on actual returns in their account, not the notional performance of their registrant. Presenting the MWRR of an account enables investors to directly measure how they are progressing toward their goals. Another goal of this project is to encourage communication between clients and their dealers and advisers. The impact of a client's choices about money flows in and out of the account is reflected with MWRR. Registrants can use this information to educate clients about the effects of their decisions about moving money in and out of their accounts. These conversations will also help clients assess the value of the advice they receive.

Registered firms that are already providing performance reports using TWRR commented that a switch to MWRR could create confusion for investors. We acknowledge this but point to the

opportunity to prepare for implementation of the new requirement over a three year period. Also, nothing prohibits a firm from providing percentage returns calculated using the TWRR method in addition to the required percentage returns calculated on a MWRR basis.

Some comment letters mentioned that the proposed requirement to use MWRR is contradictory to the standards established and administered by the CFA Institute, known as Global Investment Performance Standards (GIPS) which requires the use of TWRR. The goal of the GIPS standards is to allow prospective clients to make a more informed decision regarding the selection of an investment manager, while our goal is to show clients how their accounts have performed.

There was a suggestion that calculating percentage returns using the MWRR should be limited to 10 years, as reporting performance for periods beyond 10 years may have little value for investors, and will pose a very significant technological challenge for registered firms. We have not modified the proposed requirement because we think performance information since inception will be valuable to investors and we do not think providing this information for periods greater than 10 years will be problematic.

Some commenters recommended the Rule define a specific MWRR method that would be acceptable, and there were requests for confirmation that the Modified Dietz method or other approximation techniques would comply with the MWRR requirement. We have decided not to define acceptable methodologies within the MWRR. We have provided that for these purposes, a firm may use a methodology that is generally accepted in the securities industry. We do not think that Modified Dietz or other approximation techniques are any longer generally accepted.

16. Scholarship plan dealers

There were comments suggesting that the disclosure required under the 2012 Proposal would duplicate information already provided to clients under existing requirements. It was suggested that the relationship disclosure information delivered to investors at account opening should simply refer to the scholarship plan prospectus and/or plan summary.

There is in fact little overlap between the reporting requirements in our proposals and existing disclosure requirements applicable to scholarship plans, and we do not think one-time product purchase disclosure is sufficient in itself for an ongoing investment of this kind. We have tailored reporting requirements for scholarship plan dealers to the unique features of scholarship plans. Pre-purchase disclosure in writing of the terms of a scholarship plan, including disclosure of the front-loaded fees, the risks of the plan and the potential amount of income if invested to maturity, provides investors with essential information. This pre-purchase disclosure may be complied with by providing the summary document prepared by scholarship plans if it contains the required pre-purchase information.

There was a suggestion that an investor should receive an initial investment statement, including disclosure of the costs and conditions of the plan, within 30 days of account opening instead of pre-purchase disclosure, permitting the investor to use the information to clarify the terms and any misunderstandings within the common 60 day withdrawal right period. We think that, in

terms of investor protection, it is better to have a well-informed investor prior to the opening of an account.

One commenter did not support disclosure of the amount the investor's beneficiary may receive if the investor stays with the plan to maturity, as this amount could depend on too many unknown factors. We disagree with this position. The maximum amount the beneficiary could be entitled to in isolation could be misleading, but this amount will be provided with a summary of the plan terms, disclosure of any fees, investor options if plan payments are discontinued, and the total amount invested. Together, this information will provide investors in scholarship plans with basic information to determine what they have paid and how their investment will or has performed.

We disagree with the request that the guidance on paragraph 14.2(2)(n) in the Companion Policy should be part of the Rule and that its language be modified to include reference to the prospectus for a description of the options available to an investor who cannot maintain prescribed payments. The Rule sets out minimum requirements and a registrant may choose to add a reference to the prospectus. However, it would not be satisfactory to simply direct a client to refer to the prospectus.

Other commenters stated that disclosure of the risks and features of scholarship plans is not sufficient on its own. One commenter recommended the CSA to consider substantial regulation in this area, while the other commenter suggested that scholarship plans should be phased out entirely. We cannot address these comments as they are outside the scope of this CSA project.

17. Benchmarks

After careful consideration, we have come to agree with commenters that recommended we drop the Companion Policy guidance in the 2012 Proposals that encouraged firms to include an historical five-year GIC rate in performance reports. We have been persuaded that using such a rate may be inconsistent with the guidance that registrants should use benchmarks that are reasonably reflective of the composition of the investor's portfolio so as to ensure that a relevant comparison of performance is presented. Use of a five-year GIC as a reference point for discussions about the risk-return proposition may be appropriate for many clients, but there may be others for whom it would not.

18. Transition

The 2011 Proposal provided for an implementation period of two years for most of the new requirements. Many industry commenters then argued for an implementation period of at least three years, while investor advocates generally stated that one year would be sufficient. We were persuaded that three years would be a necessary transition period for some of the proposed new reporting requirements and provided for it in the 2012 Proposal. We do not agree with suggestions in the comments on the 2012 Proposal that even more time would be required. The transition period for investment fund managers is discussed above under "Costs and benefits".

We acknowledge the comments from others that some of the transition periods are generous. We would also like to see the proposed new disclosures in the hands of investors as soon as possible, but we have to take into consideration the time needed for the industry to develop, test and implement the necessary systems. We encourage registered firms to implement new reporting requirements before the end of transition periods if possible.

19. List of commenters

We received submissions from the following 65 commenters:

1. Advocis
2. AGF Investments Inc.
3. Alternative Investment Management Association
4. Armstrong & Quaile Assoc. Inc.
5. Association of Canadian Compliance Professionals
6. B2B Bank
7. Borden Ladner Gervais LLP
8. Canadian Foundation for Advancement of Investor Rights
9. Canadian GIPS Council
10. Canadian Imperial Bank of Commerce
11. Canfin Magellan Investments Inc.
12. Capital International Asset Management (Canada), Inc.
13. CI Financial Corp.
14. Cripps, James B. F.
15. Dundee Private Investors Inc.
16. DWM Securities Inc.
17. Edward Jones
18. Federation of Mutual Fund Dealers

19. Fidelity Investments Canada ULC
20. Franklin Templeton Investments Corp.
21. Greystone Managed Investments Inc.
22. Groupe Cloutier Investissements Inc.
23. Heathbridge Capital Management Ltd.
24. Highstreet Asset Management Inc.
25. IA Clarington Investments Inc.
26. Independent Financial Brokers of Canada
27. Independent Planning Group Inc.
28. ING Direct Funds Limited
29. Invesco Canada Ltd.
30. Investment Industry Association of Canada
31. Investment Planning Counsel Inc.
32. Investor Advisory Panel
33. Investors Group Inc.
34. Kenmar Associates
35. Killoran, Joe
36. Labbé, Jean-François G.
37. Lucyk, Christine
38. MacKenzie Financial Corporation
39. Manulife Securities Incorporated
40. MD Physician Services Inc. and MD Management Ltd.
41. MICA Capital inc.

42. Mouvement des caisses Desjardins

43. National Bank Securities Inc.

44. Pacific Spirit Investment Management Inc.

45. PEAK Investment Services Inc.

46. Porter, Hamish

47. Portfolio Management Association of Canada

48. Portfolio Strategies Corporation

49. Primerica (PFSL Investments Canada Ltd. and PFSL Fund Management Ltd.)

50. Quadrus Investment Services Ltd.

51. Royal Bank of Canada (RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc., RBC Global Asset Management Inc., RBC Phillips, Hager & North Investment Counsel Inc., and Phillips, Hager & North Investment Funds Ltd.)

52. RESP Dealers Association of Canada

53. Rogers Group Investment Advisors Ltd.

54. Scotia Asset Management L.P.

55. Scotia Capital Inc.

56. Scotia Securities Inc.

57. Steadyhand Investment Funds

58. Sun Life Financial Investment Services (Canada) Inc.

59. Sun Life Global Investments (Canada) Inc.

60. TD Asset Management Inc.

61. The Canadian Advocacy Council for Canadian CFA Institute Societies

62. The Investment Funds Institute of Canada

63. The Omega Foundation

64. Tradex Management Inc.

65. Young, Duff