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MFDA STAFF NOTICE

RELATIONSHIP DISCLOSURE

MFDA Staff Notices are intended to assist Members and their Approved Persons in the interpretation, application of and compliance with requirements under MFDA By-laws and Rules. Notices make reference to these requirements and set out MFDA staff's interpretation of how to comply with these requirements. Notices may also include best practices or guidance.

This Notice is intended to clarify the obligations of Members with respect to the requirement to provide relationship disclosure information pursuant to Rule 2.2.5. The Rule requires that, on account opening, Members provide all clients with core information about the nature of their relationship with the Member and its Approved Persons. The objective of the relationship disclosure requirement is to ensure that clients understand their obligations, the obligations of their dealer and know what to expect with respect to service levels and costs.

Application

Members are required to provide relationship disclosure to new as well as existing clients. New clients will be provided with the relationship disclosure on account opening. A transition period until September 28, 2011 has been provided to allow Members to implement the relationship disclosure requirements for new clients and a transition period of three years (expiring on December 3, 2013) has been provided to allow Members to provide the relationship disclosure to existing clients.

Form of Relationship Disclosure

Rule 2.2.5 prescribes the core elements of disclosure that must be provided to clients at account opening. The format of the relationship disclosure is not prescribed, but it must be provided to the client in writing and in plain language. The disclosure may be a stand-alone document or incorporated into other documents provided to the client at account opening.

Members are given the flexibility to provide customized relationship disclosure to each client or provide appropriate standardized relationship disclosure to all clients or separate classes of clients.

Members may provide the relationship disclosure to clients through electronic means provided requirements under securities legislation are satisfied. Members may refer to National Instrument 11-201 *Delivery of Documents by Electronic Means* and MFDA Member Regulation Notice MR-0015 *Electronic Delivery of Documents* for more information.

Content of Relationship Disclosure

Rule 2.2.5 requires that, for each new account opened, the Member shall provide written disclosure to the client:

- (a) describing the nature of the advisory relationship;
- (b) describing the products and services offered by the Member;
- (c) describing the Member's procedures regarding the receipt and handling of client cash and cheques. In the case of a Level 2 dealer, the disclosure must include an explanation that all client cheques shall be payable to the issuer or carrying dealer, as applicable;
- (d) describing the Member's obligation to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and advising when the Member will assess the suitability of the investments in the client's account;
- (e) defining the various terms with respect to the Know-Your-Client ("KYC") information collected by the Member and describing how this information will be used in assessing investments in the account;
- (f) describing the content and frequency of reporting for the account; and
- (g) describing the nature of the compensation that may be paid to the Member and referring the client to other sources for more specific information.

The following sections discuss the expectations of MFDA staff with respect to the content of the relationship disclosure document prescribed by Rule 2.2.5:

(a) Nature of the Advisory Relationship

The relationship disclosure must include a brief description of the nature of the advisory relationship and how it operates. For example, this may include a statement that the client is responsible for making investment decisions but can rely on the advice given by the Approved Person, and that the Approved Person is responsible for the advice and ensuring that it is suitable based on the client's investment needs and objectives.

(b) Nature of the Products and Services Offered

The purpose of this section is to clarify the nature of the activities for which the Member is responsible. A description of the nature of the products and services offered by the Member must be provided. Members may provide a generic description of the type or class of products sold (e.g. mutual funds, guaranteed investment certificates and principal protected notes). Where

Members only sell proprietary products or mutual funds of a related issuer, this should also be disclosed.

(c) Procedures Regarding Handling of Cash and Cheques

Disclosure of the Member's procedures regarding the receipt and handling of client cash and cheques must be provided to the client. This disclosure requirement is intended to assist clients in understanding which parties are responsible for handling their cash and to whom they should be making cheques payable. In the case of a Level 2 dealer, the disclosure must include an explanation that all client cheques shall be payable to the issuer or carrying dealer, as applicable.

Members should consider including disclosure to clients that all cheques must be made payable to the Member only and not to the Approved Person. Where Members do not allow their Approved Persons to accept cash for the purchase of securities, this should also be disclosed to the client.

(d) Suitability of Orders Accepted/Recommendations Made

MFDA Rule 2.2.5(d) requires a description of the Member's suitability obligation to clients. This will include a statement that Members are required under securities legislation and MFDA Rules to ensure each recommendation made is suitable for the client in relation to the client's investment objectives, risk tolerance and other personal circumstances. Clients should also be advised that the obligation to make a suitability determination applies to trades proposed by the client, whether or not a recommendation is made.

In addition, Members are required to advise the client of other circumstances which will trigger an assessment of the suitability of investments in the client's account, as prescribed by Rule 2.2.1(e):

- When the client transfers assets into an account at the Member;
- When the Member or Approved Persons becomes aware of a material change in client information, as defined in Rule 2.2.4; or
- When there is a change in the Approved Person responsible for the client's account at the Member.

(e) Defining KYC Terms

It is essential that clients understand the basis upon which their investments are assessed. Accordingly, KYC information must be defined in a clear and concise way to assist clients in understanding what the KYC terms mean and how the criteria will relate to the specific investments recommended or accepted by the Member.

The requirements of this section do not contemplate defining all KYC terms, as MFDA staff acknowledges that certain terms, such as age or income, are self-explanatory. However, "risk tolerance" and "investment objectives" are examples of key terms that should be defined, since Members and their clients do not always have the same understanding of these two terms.

Members and Approved Persons are advised to reference Appendix 1: Example of KYC Information of MFDA Member Regulation Notice MR-0069 *Suitability Guidelines* for guidance with respect to how to define KYC terms.

As a best practice, the definition of KYC terms should be incorporated into the New Account Application Form (“NAAF”) to ensure that clients are aware of and acknowledge the basis on which the Member and Approved Person will assess the suitability of investments for their account.

(f) Content and Frequency of Reporting

A description of the content and frequency of reporting for each account must be included in the document. Members must inform the client when trade confirmations and account statements will be sent and describe the performance reporting information that will be provided by the Member under Rule 5.3.5.

(g) Compensation and Reference to Other Sources of Information

Disclosure must include a general description of the nature of compensation paid to the Member with a reference to more specific information available through other sources. For example, this may include a statement that the Member receives a commission at the time of the sale of an investment and may earn an ongoing commission (trailer fees) for as long as the client holds the investment. Clients should also be made aware that there may be other fees or costs charged by the product manufacturer depending on the investment product. This general information with respect to how the Member is compensated and the possibility of other costs associated with making and holding investments is intended to supplement more specific product disclosure with respect to fees and costs available through the prospectus or offering memorandum.

Members may also wish to advise clients that they can speak to their advisor for more information about the nature of any fees or compensation paid to the Member.

Approval of Relationship Disclosure Materials

Where standardized relationship disclosure is provided to all clients, it must be approved by compliance staff at the Member’s head office. If the relationship disclosure is customized for each client or classes of clients, the Member should have a procedure in place that requires the approval of a supervisor at the head office and/or branch level.

Maintaining Evidence of Relationship Disclosure

Members must maintain evidence that the required relationship disclosure has been provided to clients. If the relationship disclosure is incorporated into the NAAF or account documentation and is signed by the client, maintaining a copy in the client file will be sufficient to evidence delivery.

Members that choose to provide the relationship disclosure as a stand-alone document may evidence delivery by signed client acknowledgements or by maintaining copies of disclosure documents in client files, along with detailed notes of client meetings and discussions evidencing

that the disclosure has been provided. Members are advised to reference MFDA Member Regulation Notice MR-0064 *Maintaining Evidence of Disclosure* for more guidance with respect to maintaining evidence of required disclosures.

Significant Changes

As with other disclosure requirements under MFDA Rules, where there is a significant change to information previously provided to the client, it is expected that the Member will take reasonable steps to notify the client of the changes in a timely manner. Members may advise the client of the change by including updated information with regular client communications such as account statements. A significant change would include, for example, a change in definitions of KYC terms.

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