



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Summary of National Instrument 23-102 *Use of Client Brokerage Commissions*

On October 6, 2009, the CSA announced the approval of NI 23-102 *Use of Client Brokerage Commissions* (the Instrument). The Instrument clarifies the obligations of advisors and registered dealers, when advisors obtain goods and services in connection with client brokerage commissions (otherwise known as Soft Dollar arrangements). The Instrument also introduces new disclosure requirements for advisors.

The Instrument replaces OSC Policy 1.9 and AMF Policy Statement Q-20 *Use by dealers of brokerage commissions as payment for goods or services other than order execution services (Soft Dollar Deals)*. The Instrument is expected to become effective on June 30, 2010.

Summary of NI 23-102

Commissions on Brokerage Transactions

The Instrument applies to advisors and registered dealers in situations where brokerage commissions are charged by a dealer for an account or portfolio over which the advisor has discretion to make investment decisions.

Under those circumstances, advisors cannot direct client brokerage commissions to a dealer, under formal or informal arrangements, in return for goods and services by the dealer or a third party, except in relation to “order execution goods and services” or “research goods and services.”

Where commissions are directed to a dealer for such services, the advisor must make a good faith determination that the client or client receives reasonable benefits, considering both the use of the goods or services, and the amount of brokerage commissions paid. The determination can be made either in respect of a particular transaction, or the advisor’s overall responsibilities for client accounts. This means that a specific good or service may be used to benefit more than one client, and may not always be used to directly benefit each particular client whose commissions paid for the good or service, as long as over time, such clients receive fair and reasonable benefits.

In respect of dealers' responsibilities, the Instrument states that registered dealers must not accept or forward to a third party, any commissions in return for the provision to an advisor of goods and services by the dealer or a third party other than order execution goods and services or research goods and services.

Order execution goods and services are defined as:

- a) order execution; and
- b) goods or services to the extent that they are directly related to order execution

To be considered to be directly related to order execution, goods or services should be integral to the arranging and conclusion of the transactions that generated the commissions. The goods and services must generally be provided or used between the point at which the advisor makes an investment or trading decision, and the point at which the resulting securities transaction is concluded, which is when settlement is clearly and irrevocably completed. Order execution goods and services can include: order management systems, algorithmic trading software, market data and custody, and clearing and settlement services.

Research goods and services are defined to be:

- a) advice relating to the value of a security or the advisability of effecting a transaction in a security;
- b) an analysis, or report, concerning a security, portfolio strategy, issuer, industry or an economic or political factor or trend; and
- c) a database or software, to the extent that it supports goods or services referred to in paragraphs a) and b).

Items such as databases and software that are used by advisors in support of, or as an alternative to dealers' advice, analyses and reports could be considered research goods. In order to link to order execution, they should be provided or used before an advisor makes an investment or trading decision. More specifically, traditional research reports, publications marketed to a narrow audience and directed to readers with specialized interests, seminars and conferences and trading advice would generally be considered to fall within this category. Eligible databases and software could include quantitative analytical software, market data from feeds or databases, post trade analytics from prior transactions and possibly order management systems (to the extent they provide research or assist with the research process).

Mixed Use Items are goods and services that contain some elements that may meet the definitions of order execution goods and services or research goods, and services and other elements that do not fit either category. When mixed use items are obtained through brokerage commissions the advisor should make a

reasonable allocation of those commissions paid according to the use of the goods and services.

Non-Permitted Goods and Services are those that are not sufficiently linked to the transactions that generated the commissions. For example, goods and services related to overhead associated with the operation of an advisor's business would not meet the requirements. Specific examples include office furniture and equipment (including computer hardware), trading surveillance or compliance systems, costs associated with error trades, portfolio valuation and performance measurement services, computer software that assists with admin functions, legal and accounting services, memberships, marketing services and services provided by the advisor's personnel are out of scope.

Disclosure Obligations

In respect of the use of Soft Dollars, an advisor must provide certain disclosure to the client both before the advisor opens a client account or enters into a management contract to advise an investment fund. The disclosure must include:

- (i) a description of the process for, and factors considered in, selecting a dealer to effect securities transactions, including whether receiving goods or services in addition to order execution is a factor, and whether and how the process may differ for a dealer that is an affiliated entity;
- (ii) a description of the nature of the arrangements under which order execution goods and services or research goods and services might be provided;
- (iii) a list of each type of good or service, other than order execution, that might be provided; and
- (iv) a description of the method by which the determination in paragraph 3.1(2)(b) is made.

In addition the advisor must provide the following disclosure at least annually:

- (i) the information required to be disclosed under paragraph (a) other than subparagraph (a)(iii);
- (ii) a list of each type of good or service, other than order execution, that has been provided;

- (iii) the name of any affiliated entity that provided any good or service referred to in subparagraph (ii), separately identifying each affiliated entity and each type of good or service provided by each affiliated entity; and
- (iv) a statement that the name of any other dealer or third party that provided a good or service referred to in subparagraph (ii), if that name was not disclosed under subparagraph (iii), will be provided to the client upon request.

An advisor must also maintain a record of the name of any dealer or third party that provided a good or service, other than order execution and provide that information to the client upon request.

The disclosure can be client-specific or based on firm-wide information or based on some other level of customization, as long as it relates to those clients to whom the disclosure is directed.