

1.1.3 OSC Compliance Team, Capital Markets Branch 2004 Annual Report

**2004 ANNUAL REPORT
COMPLIANCE TEAM,
CAPITAL MARKETS BRANCH, OSC**

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CAPITAL MARKETS BRANCH, OSC**

Introduction

The Compliance team of the Capital Markets branch of the Ontario Securities Commission (OSC) has prepared this report to provide guidance to investment counsel and portfolio managers (ICPMs) in complying with Ontario securities law.

The report on our activities from April 1, 2003 to March 31, 2004 is divided into two parts. The first part describes various compliance initiatives and issues relating to market participants, including ICPMs. The second part of the report deals with common deficiencies identified during compliance reviews of ICPMs. For each deficiency identified, we also include some suggested guidelines to assist ICPMs in improving their existing procedures, establishing procedures in areas where they are lacking, and to give general guidance that can help in improving the overall compliance environment. Our intent is to educate ICPMs about compliance practices and to encourage strong compliance and internal control environments. We encourage all ICPMs to use this report as a self-assessment tool to strengthen your compliance with Ontario securities law.

We issued similar reports in the previous two years. Part II of the report will highlight changes in our findings from the previous year for comparative purposes.

Similar to the previous year's annual report, we have included in Appendix A the listing of books and records that we request prior to the commencement of a compliance field examination. This is a generic listing and depending on the nature of your business, some of the items may not be applicable. ICPMs should review the listing and ensure that these books and records, if applicable, are readily available and properly maintained.

Part I. Initiatives and Other Issues

Market Timing and Late Trading

As a result of widespread trading abuses of mutual fund securities in the United States, the OSC launched its own probe into mutual fund practices on late trading and market timing. Late trading is an illegal activity which occurs when purchase or redemption orders are received after the close of business, but are filled at that day's price rather than the next day's price as required by National Instrument 81-102. Market timing involves short-term trading of mutual fund securities to take advantage of short-term discrepancies between the price of a mutual fund's securities and the stale values of the securities within the fund's portfolio. While not illegal, market timing may be detrimental to the mutual fund and its long term investors. As a result, a fund manager may be in violation of its fiduciary duty to act in the best interest of its mutual funds.

Phase one of the OSC's probe commenced in November 2003 and involved sending a letter to 105 managers of publicly offered retail mutual funds in Ontario. Fund managers were required to confirm that they have effective policies and procedures in place to detect and prevent trading abuses. The responses were analyzed and areas requiring further examination were identified. Phase two of the probe began in February 2004 and more detailed information was requested from approximately one-third of the 105 fund managers originally surveyed in phase one. The selection of fund managers in phase two of the probe was based on the information they provided and also included a random sampling of managers. The data collected in phase two of the probe identified factors requiring follow-up to determine whether any trading abuses have taken place. The follow-up information is being obtained through on-site visits of certain fund managers by joint Compliance and Enforcement teams of the OSC as part of phase three of the probe which commenced in May 2004. The OSC is sharing information with the Investment Dealers Association (IDA) and the Mutual Fund Dealers Association (MFDA) and based on the findings from the on-site visits, will take appropriate regulatory action.

Review of Scholarship Plan Dealers

In May 2003, we reviewed the operations of the five scholarship plan dealers registered with the OSC. The review was performed as part of a National Compliance Review with the participation of six other provincial securities regulators. Our review looked at both the head office and branch operations of the dealers, while the other participating jurisdictions focused only on reviews of the branches. The findings were consistent among all the participating jurisdictions and many deficiencies were noted as a result of inadequate compliance structures. In particular, the supervision of sales representatives, the review of trade transactions and new accounts and the use of misleading marketing materials were major issues identified during the reviews.

Each firm responded to the deficiencies identified during the compliance reviews and indicated the action that they would take to resolve each deficiency. In April 2004, we revisited the dealers to perform a limited follow-up review to assess whether the corrective actions were successfully implemented. We are continuing to work with the scholarship plan dealers to ensure that improved compliance and internal controls are implemented and enforced. More information on the findings from these reviews will be published in an Industry Report in the near future. The report will highlight the common deficiencies noted and some

suggested guidelines in a format similar to this report. Those dealers that have not taken adequate measures to correct the deficiencies may also be subject to further regulatory action.

Referral Arrangements

The OSC has received a number of exemption applications and queries relating to acceptable referral arrangements. We are leading a policy project on referral arrangements in order to develop a staff position on this issue. We will consider several issues, including what constitutes a referral arrangement, what parties can enter into a referral arrangement and whether registration will be required for parties entering into a referral arrangement. We will continue this OSC initiative in fiscal 2005 in order to develop our policy position on these arrangements.

Business Arrangements

Accommodating clients' needs poses problems for mutual fund dealers whose registration category limits the type of investments in which they can deal. In response to these competitive pressures, some mutual fund dealers have entered into arrangements with investment dealers to meet their clients' needs. These arrangements include joint service arrangements, omnibus accounts at investment dealers and referral arrangements. We have regulatory concerns about the possible implications of these arrangements and whether mutual fund dealers are acting outside of their category of registration. Compliance and Market Regulation staff have been working with the self-regulatory organizations to analyze the issues. The MFDA and the IDA have also looked at these business arrangements and provided joint recommendations to the OSC, however, we continue to have concerns about these arrangements. We communicated the recommendations and our concerns to the Commission and we will be consulting with the public in fiscal 2005 in order to develop appropriate solutions to these issues.

Update on Risk Assessment Project

In fiscal 2001, we initiated a project to develop a risk-based selection model for routine compliance examinations of advisers and fund managers. The model is intended to focus our staffing resources on those market participants and the specific areas of their operations considered to be the most risky. The model calculates a risk score for each market participant based on responses from the risk assessment questionnaires which were initially distributed to all market participants in fiscal 2002. The risk assessment questionnaires were developed to populate the model by gathering information from market participants on their operations, nature of their products and client base. The risk score generated from these questionnaires corresponds to a specific risk ranking of high, medium-high, medium-low and low.

Commencing in April 2003, we implemented our risk-based approach for performing compliance reviews. As a first step, we met with senior management of all market participants who were assigned a high risk score to communicate their overall risk ranking and to discuss those areas of their operations which contributed to their score. As a general practice, the disclosure of a market participant's risk score is provided on a confidential basis at the completion of our compliance review.

In May 2004, all advisers and fund managers were asked to complete a revised risk assessment questionnaire with information that is current as at March 31, 2004. During the summer of 2004, we will be reviewing the risk assessment questionnaires that have been submitted to ensure that the information is complete and accurate. Consistent with the previous practice, a risk score and corresponding ranking will be generated for all fund managers and advisers. Not only will the ranking assist us to determine the frequency, extent and timing of a field review, but the completed questionnaires will assist us in further developing the risk assessment model.

Proxy Voting

For the period April 1, 2003 to March 31, 2004, we noted an increase in the number of deficiencies relating to proxy voting. Although the issue was not included as one of the common ICPM deficiencies listed in Part II, 45% of firms reviewed had deficiencies related to proxy voting as compared to 17% in the previous year. Part of the reason for this increase was our additional focus on this area as part of our field examinations during the past year.

Ontario securities law does not explicitly address the obligations of advisers and fund managers to vote proxies on behalf of their clients. The exception to this applies to advisers who have a requirement to vote clients' proxies in accordance with their written instructions, when given. Otherwise, Ontario securities law does contain general principles that may be applied to an adviser's proxy voting duties. For example, advisers are required to develop and enforce written policies and procedures that conform with prudent business practice which enable them to adequately serve their clients. Furthermore, advisers have a duty to deal fairly, honestly and in good faith with their clients. Accordingly, advisers should have written policies and procedures that provide guidance on proxy voting for both contentious and routine matters, the responsibility for proxy voting should be outlined in the advisory contracts and clients' proxies should be voted in their best interests.

Recent compliance field reviews have shown that many advisers have inadequate written policies and procedures on proxy voting. Also, we noted that proxies were not always voted and there was no process to deal with contentious matters. Another common issue was the lack of disclosure of the proxy voting responsibility in the investment management agreement with clients.

Part II. Common ICPM Deficiencies

This part of the report discusses those deficiencies that occurred with the most frequency based on Compliance examinations conducted from April 1, 2003 to March 31, 2004. A necessary element of a market participant's business is a compliance program that effectively addresses the inherent risks in the business of advising and helps the firm meet its compliance obligations under securities law. An effective compliance program increases the firm's compliance with regulatory requirements. This report is meant to provide guidance and help ICPMs review their compliance programs, supervisory and internal control procedures and to establish a stronger compliance environment.

The ten most common deficiencies noted in our reviews of ICPMs are shown in the chart below with comparatives from the previous year.¹

| COMMON DEFICIENCY | 2004 Ranking | 2004 % ² | 2003 Ranking | 2003 % |
|---|--------------|---------------------|--------------|--------|
| Policies and procedures manual | 1 | 97 | 3 | 83 |
| Policy for fairness in the allocation of investment opportunities | 2 | 85 | 2 | 90 |
| Statement of policies | 3 | 82 | 5 | 72 |
| Portfolio management | 4 | 82 | 7 | 59 |
| Maintenance of books and records | 5 | 79 | 1 | 90 |
| Capital calculations | 6 | 73 | 4 | 83 |
| Registration issues | 7 | 61 | 6 | 62 |
| Marketing | 8 | 61 | 8 | 55 |
| Personal trading | 9 | 55 | 10 | 48 |
| Know your client and suitability information | 10 | 48 | 9 | 52 |

The common deficiencies are presented under broad headings which comprise a myriad of weaknesses. Our findings reflect that ICPMs may have one or more of these weaknesses and would therefore, be included in the overall percentage of firms being deficient. They are not meant to imply that firms were deficient in all of the areas that would be grouped under one common deficiency.

The above chart indicates that there has been no change to the common deficiencies from those identified in the previous review period. This would be expected to some degree since the firms reviewed each year differ from those examined in the prior year. Also, due to the scope of our compliance review program and the areas that are examined at each ICPM, it is not unusual to experience similarities from year to year, especially due to the broad headings used as described above. Unfortunately, it appears that the incidence of some of these deficiencies has increased from the previous year as indicated by the higher percentage of firms being deficient. It is hoped that ICPMs will use this report as a learning tool and review the noted deficiencies and the suggested guidelines such that the occurrence of these deficiencies will be reduced.

In general, no significant improvements were noted from the previous year. The most negative trend was noted in the area of portfolio management with 82% of firms experiencing issues in this area as compared to 59% in the prior year. The types of issues noted for each of the common deficiencies will be dealt with in more detail in the section below.

1. Policies and procedures manual

ICPMs are required to establish and enforce written policies and procedures that will enable them to serve their clients adequately. ICPMs should prepare a policies and procedures manual which contains the relevant regulatory requirements. Policies and procedures which are clearly documented and enforced contribute to a strong compliance environment.

¹ We also identified issues in numerous other areas at ICPMs, such as: monitoring of subadvisers, statement of client's portfolio, allocation of commissions, conflicts of interest, cross transactions, soft dollar issues, related registrant disclosure, annual consent to trade securities of related and connected issuers, compliance function, adhering to the terms and conditions of registration, insurance coverage, exempt securities issues, early warning and insider trading reporting, proxy voting issues, United Nations Suppression of Terrorism monthly reporting, internal controls, segregation of duties, trust accounts, agreements with service providers, and confidentiality agreements.

² The percentage is based on the number of ICPMs noted with this deficiency.

During our reviews, we observed the following:

- The procedures used in practice were not consistent with the procedures outlined in the manual
- The procedures outlined in the manual did not apply to the business conducted
- The manual did not reflect recent changes to the rules and regulations of the Act or other applicable legislation, in particular those related to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act and Regulations*
- The policies and procedures manual contained out-dated references to the rules and regulations of the Act
- The manual did not contain procedures covering all major areas of the business
- The manual was not sufficiently detailed
- The manual was not made available to all staff

Suggested practices

Each ICPM should establish and enforce a written policies and procedures manual that is sufficiently detailed, updated periodically, and covers all areas of its business. The following list of topics should be considered for inclusion in a standard manual:

Portfolio Management

- Collection, documentation, and timely updating, of Know Your Client (KYC) and suitability information for clients
- Compliance with client's specified investment restrictions or any other instructions
- Performance of sufficient research to support investment decisions
- Supervision of sub-advisers and junior portfolio managers

Trading and Brokerage

- Guidelines on the selection of brokers
- Obtaining best price and best execution for clients
- Fairness in allocation of investment opportunities among client accounts
- Executing trades in a timely manner and in accordance with instructions
- Monitoring and resolving failed trades and trading errors
- Guidelines on soft dollar arrangements with brokers

Compliance

- Compliance with all regulatory requirements, including reviewing the opening of accounts, and subsequent trades for suitability
- Ensure registration forms/notices/filings are submitted within the specified period
- Preparation and monitoring of monthly capital calculations
- Insider reporting and early warning reporting
- United Nations Suppression of Terrorism monthly reporting
- Monitoring and resolving conflicts of interest and personal trading

- Handling of client complaints
- Compliance with regulatory requirements of all jurisdictions where business is conducted

Money Laundering Prevention

- Definition of “money laundering” and examples of suspicious transactions
- Handling of prescribed and suspicious transactions
- Procedures to report prescribed and suspicious transactions to the Financial Transactions and Reports Analysis Centre of Canada
- Documenting the records which should be maintained under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act and Regulations*

Proxy Voting

- Guidelines ensuring all proxies are voted in the best interest of clients and in a timely manner
- Maintaining a record of the receipt of proxies and how they are voted
- Guidance with respect to voting on different issues (e.g. management stock options, poison pills, acquisitions), including dealing with conflicts of interest
- Procedures to ensure proxies are voted in accordance with internal policies

2. Policy for fairness in allocation of investment opportunities

Every investment counsel must have standards to ensure fairness in the allocation of investment opportunities among its clients. ICPMs are required to prepare a written fairness policy dealing with the allocation of investment opportunities among clients. The policy must be filed with the Commission as well as distributed to all clients. The policy should specify the method used by the ICPM to allocate securities purchased in block trades and/or initial public offerings (IPOs) to client accounts, including their in-house pools. The policy should also include the method used by the ICPM to allocate price and commissions on these trades among client accounts. Advisers have a fiduciary duty to clients to allocate trades equitably among client accounts.

During our reviews, we observed the following:

- The ICPM had not prepared a fairness policy
- The ICPM had not filed the most current fairness policy with the Commission and/or did not provide all clients with a recent copy
- The fairness policy did not include a methodology for allocating block trades and how the security prices and commissions will be determined
- The fairness policy did not include a methodology for allocating partial fills, and limited issues
- The policy contained incorrect information

Suggested practices

Each ICPM should tailor its fairness policy to address all relevant areas of its business. At a minimum, it should state:

- How price and commissions are allocated among client accounts when trades are blocked
- How block trades are allocated among client accounts when there is only a partial fill
- The process for determining which clients will participate in “hot issues” and IPOs
- The process for the allocation of prices and commissions for block trades that are filled in different lots and/or at different prices

3. Statement of policies

ICPMs who provide advice with respect to their own securities or securities of certain issuers who are connected or related to them are required to disclose these relationships. Every registrant is required to include this disclosure in a statement of policies which is to be filed with the Commission, as well as distributed to each client. Regulation 223 requires that registrants prepare and file a statement of policies with the Commission as well as provide a copy to their clients.

During our reviews, we observed some the following deficiencies:

- The ICPM had not prepared a statement of policies
- The ICPM had not filed the most current statement of policies with the Commission and/or did not provide all clients with a copy
- The ICPM had not updated its statement of policies to include all related issuers
- The ICPM did not list its own pooled funds/mutual funds as related issuers
- The ICPM did not describe the nature of its relationship with related and connected issuers
- The disclosure required in Regulation 223(1)(d) was not in bold type

Suggested practices

- A current statement of policies should be prepared and filed with the Commission and distributed to all clients
- If a significant change occurs, a revised statement of policies must be filed with the Commission and distributed to all clients
- The statement of policies should include a complete listing of related issuers along with a concise description of the nature of the relationship with each of the related issuers
- The statement should include the disclosure required in Regulation 223(1)(d) in bold type

4. Portfolio Management

Portfolio management is the provision of investment advice to clients based on their stated investment objectives. Advisory agreements govern the portfolio management activities performed by advisers on their client's behalf. Thus, it should contain adequate disclosure of all material facts, such as the responsibilities of each of the parties involved, clients' investment objectives and restrictions, the timing and billing of fees, the degree of discretion in the management of client assets, and how the agreement may be terminated.

During our reviews, we observed the following:

- Advisory agreements were not always signed by the client
- Client accounts were managed without an advisory agreement
- Clauses in the agreement contradicted the advisor's fiduciary duty to the client
- Client's investment objectives and restrictions were not documented
- Portfolio holdings were inconsistent with the investment restrictions
- The advisory fee schedule was not included in the advisory agreement
- The timing and method of billing was not included in the agreement
- Responsibility of voting client proxies was not addressed
- Responsibility of insider reporting or early warning reporting, on the client's behalf, was not addressed

- Inaccurate/outdated references were included in the advisory agreement
- Client's written consent to charge fees based on performance was not obtained

Suggested practices

- The advisory agreement should be executed prior to the commencement of managing the account and after client consent has been given
- Advisory agreements should be updated whenever any terms have changed
- The advisory agreement should detail the responsibilities of each of the parties involved
- Written notice should be obtained prior to terminating any advisory agreement
- A review of client holdings should be done on a frequent basis to ensure that holdings are consistent with the investment objectives and restrictions

5. Maintenance of books and records

ICPMs are required to maintain books and records necessary to properly record their business transactions, trading transactions and other financial affairs. Regulation 113(1) requires them to maintain the books and records that are necessary to properly record their business transactions.

During our reviews, we observed the following:

- The ICPM did not maintain a trade blotter or the blotter maintained was incomplete
- The ICPM did not maintain copies of each trade order or instruction
- Trade orders were not time-stamped
- A log of failed trades and trading errors was not maintained
- No support for prices of over the counter (OTC), private placements or thinly traded securities was maintained
- Client files do not contain advisory agreements
- Client investment objectives and restrictions were not in the client file
- Investment research not kept on file
- A complaints log, including the nature and resolution, was not maintained
- Proxies voted or proxy log was not maintained
- Cash and security reconciliations were not reviewed and approved by someone other than the preparer or not prepared at all
- No evidence that portfolio holdings or securities reconciliations were reviewed
- Commission filings and board minutes were not maintained

Suggested practices

A list of books and records that ICPMs are required to maintain is contained in Regulation 113(3). ICPMs should also retain any other books and records necessary to properly record their business transactions, trading transactions, and other financial affairs.

6. Capital calculations

ICPMs are required to prepare a monthly calculation of minimum free capital and capital required within a reasonable period of time after each month end. The capital calculation is to be prepared based on monthly financial statements prepared in accordance with generally accepted accounting principles (GAAP). ICPMs are required to inform the Commission immediately should they become capital deficient. They are required to rectify the capital deficiency within 48 hours. Staff practice is to impose terms and conditions on all registrants that are capital deficient. The terms and conditions would include the monthly submission of a capital calculation.

During our reviews, we observed the following:

- Capital calculations were not prepared monthly or were not prepared on a timely basis and therefore, monitoring of the firm's capital was not performed
- Capital calculations were incorrectly calculated
- The insurance deductible on the financial institution bond was not included in the calculation or an incorrect amount was included
- The minimum capital deduction used was incorrect
- Long-term assets and liabilities were incorrectly included in the calculation of working capital and/or current assets and liabilities were incorrectly excluded
- There was no evidence that a review of the calculation was performed by someone other than the preparer
- Copies of the monthly capital calculations were not maintained
- The ICPM was capital deficient and did not inform the Commission

Suggested practices

- The ICPM's capital position should be calculated on a monthly basis and should be based on financial statements prepared in accordance with GAAP
- Copies of the calculations should be maintained
- A person other than the preparer should review the calculations to ensure they are accurate and evidence of the review should be documented
- The Commission should be informed immediately should the ICPM's capital position become deficient

7. Registration issues

Every registered adviser is required to notify the OSC of any change in the status of directors and/or officers within five business days. Also, an adviser is required to notify the Commission of the opening of any office or branch, and of any changes in the status of the compliance officer, portfolio managers, and representatives. Trade names can be used when conducting registerable activity if the registered adviser has previously notified the Commission.

During our reviews, we observed the following:

- ICPMs engaged in unregistered trading activity which is not permitted by their category of registration
- Affiliated entities of the ICPM were performing advisory activities, but were not registered to do so
- Individuals that were officers and/or directors were not registered with the OSC
- Individuals that were portfolio managers, representatives, compliance officers were not registered with the OSC
- Commission was not notified of changes in registration
- Notices were late in being filed with the OSC

- The trade name or parent company's name used in signage, correspondence, business cards and marketing materials was not registered with the OSC

Suggested practices

- Notify the OSC of all changes in a timely manner

8. Marketing

In order to deal fairly, honestly and in good faith with clients it is necessary to ensure that all marketing material include accurate information that is not misleading to clients. When marketing mutual funds, the requirements of Part 15 of NI 81-102 must be adhered to.

During our reviews, we observed the following:

- Internal marketing requirements were not being adhered to
- Marketing materials contained information that was incorrect
- Marketing materials were outdated or had inadequate disclosure
- Web-site information was incorrect, outdated or contained inadequate disclosure
- Performance data included accounts not managed by the ICPM
- Performance data incorrectly used return data from a different fund/period
- Composites used in marketing materials did not include all the fee-paying accounts or were not grouped according to similar investment mandates
- References to the Association for Investment Management and Research ("AIMR") were used when the firm was not AIMR compliant or was incorrectly worded
- Claims of "superior performance" were made that could not be substantiated
- Claims regarding the future value of investments
- The disclosure and warning language required by 15.2(2) of NI 81-102 was not always present
- Performance data of mutual funds was not disclosed for the required time periods
- No evidence was maintained of any review of marketing material

Suggested practices

- Marketing material should be regularly updated to ensure all information is complete and accurate and not misleading to clients
- Establish and enforce procedures with respect to the preparation, review and approval of marketing materials
- Establish guidelines on the preparation of performance data and the construction of composites
- Mutual fund sales communications made in accordance with Part 15 of National Instrument 81-102
- Require the approval of all marketing material from someone independent of its preparation and maintain evidence of such approval

9. Personal Trading

ICPMs are required to establish and enforce written procedures for dealing with clients that conform to prudent business practice. The establishment and enforcement of a detailed policy on the personal trading of responsible persons is a prudent

business practice. It will ensure that conflicts of interest and abusive practices are avoided. A responsible person is defined in subsection 118(1) of the Act.

During our reviews, we observed the following:

- Personal trades did not require pre-clearance
- Pre-clearance approval instruction had no/excessive time limits
- Personal trading policies exist but were inconsistent with ICPMs actual practice
- Personal trading procedures did not detect violations of the personal trading policy
- Pre-approval forms were not always matched against employees' statements
- A log of personal trading pre-approvals was not maintained
- No code of ethics or annual certification of adherence was required to be signed by employees
- Individuals with access to investment making decisions were not subject to personal trading policies
- No definition of "non-public" or "material" information provided in the procedures
- Personal trading policy did not include blackout periods
- No punitive measures exist for breaches or violations of personal trading policies

Suggested practices

- Distribute clear personal trading restrictions and reporting obligations to all responsible persons
- Personal trading procedures should include blackout periods, the requirement for pre-approval of all personal trades and a review of brokerage statements
- Require all responsible persons, on an annual basis, to acknowledge in writing that they understand and will abide by the firm's personal trading policies
- Employees should direct their brokers to send statements of their accounts directly to their employer
- Maintain a record of personal trade pre-approvals and employees' brokerage statements as documentary evidence that personal trading is being monitored
- Designate a compliance officer who is responsible for reviewing and maintaining personal trading records
- On a monthly or quarterly basis, review employee statements and reconcile all trades to the approvals granted
- Put a process in place to deal with personal trading violations, including penalties for non-compliance

10. Know your client and suitability information

ICPMs are required to collect and maintain current KYC information that would allow the ICPM to ascertain general investment needs of its clients, as well as the suitability of a proposed transaction. ICPMs should collect client information such as investment objectives, risk tolerance, investment restrictions, investment time frame, annual income, and net worth.

During our reviews, we observed the following:

- KYC information was not collected for all portfolio management clients
- KYC information was not collected for clients who purchased securities on an exempt basis
- KYC information that had been collected was not complete

- KYC information had not been updated periodically
- KYC information was not formally documented
- KYC forms were not signed or dated by clients

Suggested practices

- Complete KYC information must be collected for all clients, including clients that are only sold exempt products (i.e. units in a pooled fund)
- KYC information should be periodically updated
- Clients must sign the KYC information form
- A pending file should be maintained for incomplete KYC forms which should be cleared on a timely basis and prior to any trade execution

APPENDIX A

**ADVISER COMPLIANCE FIELD REVIEW
LIST OF BOOKS AND RECORDS REQUESTED FOR REVIEW**

A. Planning -Field

1. A copy of the Registrant's statement of policies as required by Regulation 223
2. A copy of the Registrant's standards to ensure fairness in the allocation of investment opportunities among its clients as required by Regulation 115
3. A copy of the Registrant's disclosure of its related registrants and the policies and procedures adopted to minimize the potential for conflict of interest resulting from these relationships as required by OSC Rule 31-501
4. A copy of the Registrant's current organizational chart and a listing of employees with telephone numbers
5. A list of individuals responsible for providing investment advice to clients during the review period, and the name of the compliance officer
6. A list of all individuals that are subject to "close supervision" terms and conditions imposed by the Commission
7. A list of all branch offices, including those that were closed during the review period
8. A list of all affiliated parties to the Registrant and the nature of the relationship
9. A copy of any reports issued during the review period by the Registrant's internal audit department, including a copy of management's response
10. A copy of any management letters issued during the review period by the Registrant's external auditor, including a copy of management's response
11. A copy of all minutes of meetings of the Board of Directors, Audit Committee, Investment Committee or other committees of the Registrant, during the review period

B. Financial Condition

12. A copy of the Registrant's financial statements as at the end of the most recent fiscal year and as at the end of the review period
13. A copy of the monthly capital calculations for the entire review period
14. A copy of the insurance certificate of renewal

C. Contracts

15. A list of clients as at the end of the review period. For each client, identify the custodian, type of account (e.g. equity, balanced, fixed income), whether or not the Registrant has discretionary authority, and the total amount of assets under management
16. A list of clients whose contract provides for performance based compensation
17. A copy of each of the Registrant's standard advisory contracts or agreements
18. A copy of powers of attorney or letters of authorization that confer discretionary authority, if not incorporated directly in the contracts specified in item 17
19. A copy of the Registrant's fee schedule, if not included in the contracts specified in item 17

D. Portfolio Management

20. A list of any joint ventures or any other businesses in which the Registrant or any officer, director, portfolio manager or trader of the Registrant participates or has any interest in

21. Total assets under management as at the end of the review period
22. A copy of any sub-advisory agreements with other investment advisers
23. Client files, including access to former clients' files
- E. Trading & Brokerage**
24. A list of clients who have instructed the Registrant to direct a portion or the entirety of their brokerage to particular broker-dealers, including the name of the brokerage firm and the client's reason for such direction, if known
25. A list of all initial public offerings that the Registrant participated in during the review period
26. A list of all brokerage firms where client transactions were effected during the review period, identifying the name of the firm, amount of agency commissions paid and the volume of transactions
27. A list of all soft-dollar arrangements. This list should include the name of the broker or other entity involved, the nature of the goods or services received by the Registrant and the approximate annual amount of commissions on securities transactions needed to satisfy each arrangement
28. A listing of all cross transactions which took place during the review period
29. If the Registrant, its related persons or affiliates have custody of client funds or securities, a list which includes the names of all such clients, the current market value of all assets in their possession or to which the Registrant has access, and the location(s) where such assets are held
30. A list of all proprietary trading or investment accounts of the Registrant or of any "associated persons". "Associate" is defined in the *Ontario Securities Act* ("Act")
31. A list of accounts of individuals who are directly or indirectly related to the Registrant or any of its related persons, the account number, and the person to whom he/she is related
32. A list of all persons required to report personal securities transactions to the Registrant during the review period, including any officer or employee of Registrant's affiliates deemed as associated persons
33. Records of employee personal securities transactions including those for any person deemed to be associated persons during the review period
34. Listing of all securities held in all client portfolios (aggregate position totals for all securities) as of the beginning and end of the review period. This list should show the name of each security and the aggregate number of shares or principal amount held for total client portfolios.
35. Registrant's trading blotter for the review period. If possible, provide the information in chronological order with the following fields of data:
 - a. Trade date
 - b. Type of transaction (i.e. buy/sell)
 - c. Number of shares or principal amount
 - d. Security name
 - e. Identifying number (e.g. cusip number)
 - f. Price
 - g. Total commission
 - h. Commission in cents per share
 - i. Fees
 - j. Accrued interest
 - k. Net amount to/from client
 - l. Client name
 - m. Client account number
 - n. Broker or dealer name

If possible, please provide the trading blotter in Microsoft Excel compatible format on 3.5inch diskette
36. A copy of the Registrant's written policies and procedures manual

F. Custody

- 37. General ledger, trial balance, cash receipts and disbursements journals and bank reconciliations for all trust accounts for the review period
- 38. Bank statements, deposit books and cancelled cheques for the review period for all trust accounts

G. Marketing

- 39. A copy of any promotional brochures, pamphlets, or other materials routinely furnished to prospective clients (e.g. proposals); and a copy of any marketing materials (e.g. newspaper or magazine ads, radio scripts, reprints, seminar materials etc.) used to inform or solicit clients. If the Registrant makes information about its services available on the INTERNET, provide the address.
- 40. A copy of any composite or representative performance reports, data, or graphs currently disseminated to clients or prospective clients
- 41. The criteria the Registrant employs in the construction of any composite or performance data included in the records described above
- 42. A list of all parties that received any referral fees during the review period

H. Administration

- 43. Complaint log and complaint files for the review period

I. Conflicts of Interest

- 44. A copy of written policies and procedures and any Code of Ethics governing the personal securities transactions of the Registrant's employees and those of participating affiliates.
- 45. Access to a log of all instances of non-compliance with the Registrant's Code of Ethics for the review period including resolutions to the non-compliance

J. Money Laundering

- 46. A copy of the policies and procedures for money laundering

Contact Information

For further information, please contact:

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