

Registrant Outreach and Education Seminar

Performance Reporting Basics



Kathy Ferguson, MBA

Laws and regulations

Annual investment performance reports

Market value

Performance and sales communications

- Section 75.2 of the Act requires firms to deal fairly, honestly and in good faith with their clients
- Section 100(2) of the Act prohibits registrants from making statements about matters that a reasonable investor would consider important if such statements are untrue or omit information that is necessary to prevent the statements from being false or misleading.

- NI 31-103
 - Section 14.18 - Investment performance report
 - Section 14.19 - Content of investment performance report
 - Section 14.20 - Delivery of report on charges and other compensation and investment performance report

- NI 81-106
 - Part 14, Calculation of Net Asset Value

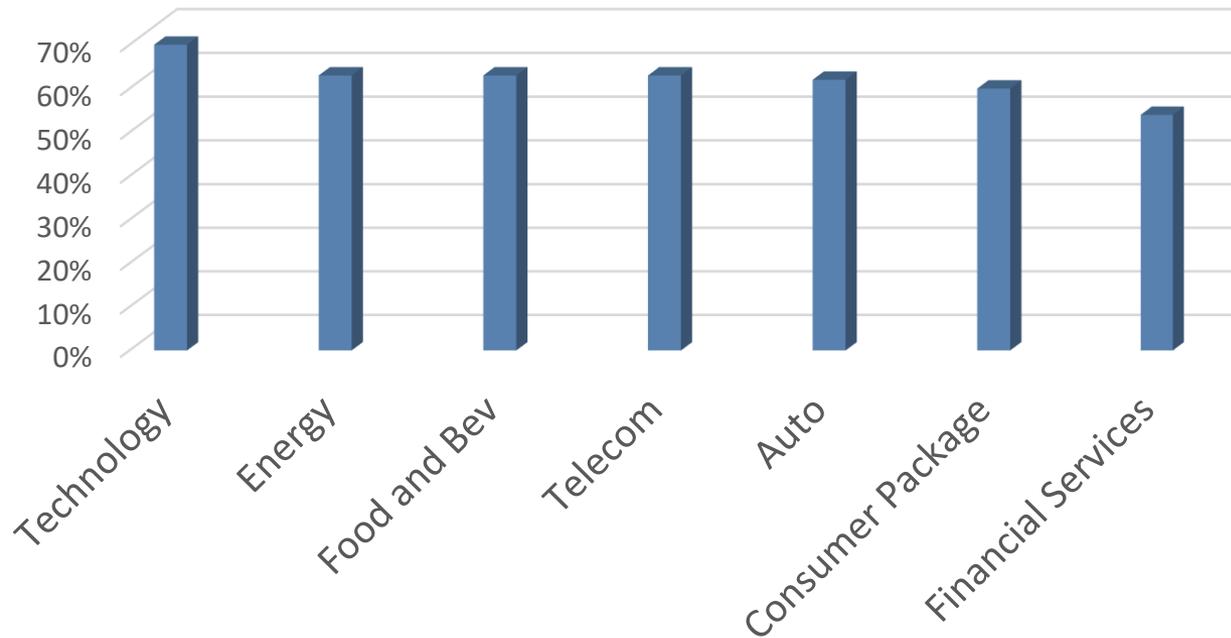
- NI 81-102
 - Part 15, Sales Communications and Prohibited Representations

- NI 31-103CP
 - Part 14
- NI 81-106 CP
 - Part 9, Net Asset Value
- NI 81-102CP
 - Part 13, Sales Communications and Prohibited Representations
- ASC Notice 33-705
- CSA Staff Notice 31-345 Cost Disclosure, Performance Reporting and Client Statements
- CSA Staff Notice 31-325 Marketing Practices of Portfolio Managers (July 2011)

- Client Relationship Model Phase 2 (CRM2)
- Three year transition period, from 2013 to 2016

“Do you trust this industry to do the right thing?”

2018 Edelman Trust Survey



Top attributes that build trust in an investment manager

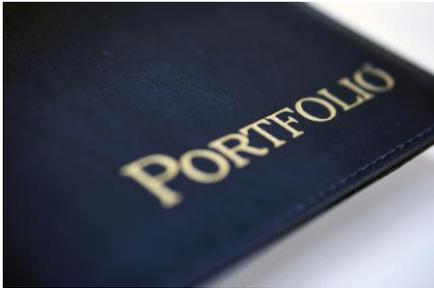
2013 CFA/Edelman Survey



Who must send investment performance reports to clients?

- Advisers
- And EMDs if...

Performance statements are sent to clients



When must performance reporting be sent?

- The account has existed for at least 12 months and within 24 months of the first trade
- Every 12 months thereafter

Not required:

- Where a client account has existed < 12 months
 - For a dealer executing trades only as directed by a registered adviser acting for the client
 - For permitted clients that are not individuals
 - When no market value can be determined for any of the securities
 - When client ceases to be a client
-

Must contain text, tables and charts showing:

- Change in value for 12 month period
- Change in value since inception
- Annualized total % return net of charges (money-weighted)
- Definition of annualized total return
 - Including that it is net of charges
 - The calculation method used (money-weighted)
 - Simple explanation of what the calculation method takes into account

Change in value – 12 month period

A	Market value of all cash and securities at Y/E	\$1,015
B	Market value of all cash and securities at beginning of 12 month period	\$1,000
C	Market value of all deposits and transfers in	\$4
D	Market value of all withdrawals and transfers out	\$17
	Annual change in market value of account A - B - C + D	\$28

Change in value – since account opening

A	Closing market value at Y/E	\$49,785.21
E	Market value of all deposits and transfers in since account opening*	\$22,500.00
F	Market value of all deposits and transfers out since account opening	\$4,900.00
	Cumulative change in market value of account A - E + F	\$32,185.21

*Date Opened: dd/mm/yr

- Money-weighted rate of return
 - Personal rate of return, that is, what the account has experienced
 - Equivalent to the IRR (internal rate of return)
 - Takes into account cash flows in the account, if any
 - Calculated with a financial calculator or Excel IRR formula

	Past year	Past 3 years	Past 5 years	Past 10 years	Since inception
Your account	12.40%	5.42%	4.67%	6.77%	9.88%

Excel XIRR example

		Year 1	Year 2	Year 3
Starting value	-\$ 100,000.00			
Deposits (+)		\$ 10,000.00		
Withdrawals (-)			-\$ 4,000.00	
Dividends (+)		\$ 4,000.00	\$ 6,000.00	\$ 6,000.00
Ending Value				\$ 98,000.00
Total Cash Flows	-\$ 100,000.00	\$ 14,000.00	\$ 2,000.00	\$ 104,000.00
			IRR	6.89%

- “This shows the total percentage return of your account for the period ending MM/DD/YYYY. Returns are calculated after charges have been deducted. These include charges you pay for advice, transaction charges and account-related charges, but not income tax.”
- “We use a money weighted method to calculate rates of return. The returns in this table are your personal rates of return.”
- “Your returns are affected by changes in the value of the securities you have invested in, dividends and interest that they paid, and also deposits and withdrawals to and from your account.”
 - Appendix E, NI 31-103CP

- For now, at a minimum it must include the 12-month return and annualized “since inception” return
 - A period of less than one year from inception must not be annualized
- 3 year return – statement period ending December 31, 2018
- 5 year return – statement period ending December 31, 2020
- 10 year return – statement period ending December 31, 2025
(calendar year-end examples above)

14.1.1 Duty to provide information

- IFM has the duty to provide information, including NAV, to enable dealers and advisers to meet their reporting obligations
- For a non-listed investment fund, market value will be the NAV provided by the investment fund manager

For other securities, market value is “the amount that the registered firm reasonably believes to be the market value of the security” after referring to:

- Last bid (long) quoted on a market or last ask (short) and making any adjustment necessary
- Inter-dealer price quote or published market reports and making any adjustment necessary
- Policies of the firm, using
 - Observable inputs
 - Unobservable inputs

- What are the valuation policies and procedures of the firm?
- What are the firm's policies with respect to estimates?
- Notification to client
 - “There is no active market for this security so we have estimated its market value.”

- Process for monitoring significant events or other situations that could affect the security
- Methodology for determining fair value for illiquid securities
- Methods by which the manager will review and test valuations to evaluate the quality of the prices obtained as well as the general functioning of the valuation process
- Should consider whether its valuation process deals with conflicts of interest

- The security is illiquid
- There is little or no issuer and issuer-related financial data available, or the data is stale
- There is little or no financial data available for comparable issuers or for the issuer's business sector
- There is not enough data to use the International Financial Reporting Standards (IFRS) based valuation methodologies
- The acquisition cost of the security is no longer a good estimate of the security's market value as the cost is outside the range of possible values for the security

- If the firm reasonably believes it cannot determine the market value of a security, it must report its value as “not determinable” in client statements and exclude it from the calculations in client statements and performance reports
- Must be reasonable basis for “not determinable”
 - Not just because the security is illiquid
- Firm must make a judgement in moving from “not determinable” to “\$0”

Can the firm rely on the valuation provided by the issuer?

- The firm is responsible for the information reported to its clients.

“The firm may not simply take valuation information from an issuer and pass it on to clients as the market value for purposes of the firm’s reporting obligations. The firm must exercise its professional judgement as to the reliability of information provided by an issuer as an input to the firm’s determination of market value. It should retain a record of the reasons for its decision.” – CSA Staff Notice 31-345

- For mortgage investment entities, portfolio impairments must be recognized and NAV adjustments made
- *IFRS 9 Financial Instruments* will apply to 2018 financial statements and will have a particular impact on accounting for impairments
- Dividend distributions are not the same as annualized rates of return

“Ethical standards for investment performance to ensure fair representation and full disclosure of investment performance”

- CFA Institute developed global standards for calculating and presenting investment performance
- Continually updated through interpretations, guidance and new provisions
- Many institutional investors, and increasingly, the HNWI sector, demand GIPS compliance. GIPS compliance enhances a firm’s credibility when marketing to institutional investors and investment consultants

- Must disclose a benchmark, and if you can't find an appropriate one, disclose why there isn't one
- If there are assets which have been hard to value and you have applied anything other than a market price, you must disclose what method you have used to value them
- Use of hypothetical or back-dated portfolios or a model return is not permitted under GIPS
- Mandatory disclosures

A representation of investment performance would be misleading if it is:

- a portrayal of past income or asset growth that gives an impression of investment results that is not justified;
- a representation about security of capital that is not justified, or a representation about possible future gains or income; or
- a presentation of past investment performance that implies that future gains or income may be inferred from past performance.

- “Over 20% gain in 2016”
 - Which fund?
 - Net of fees or gross of fees?
 - Selective time period
- Graphs that compare performance against completely different types of securities (i.e. inappropriate benchmarks)
- Stale performance
- “Outperformed the industry benchmark at key times”

- Question of fairness
- If you refer to a credit rating, that rating must be current and prepared by a designated rating organization
- If you use a benchmark, it must be a fair comparison, and not misleading

Questions?

- Thank you for your attention!

Know-Your-Product (KYP) – Issues



Adam Hillier, Senior Regulatory Analyst
Matias Pendola, Senior Regulatory Analyst

- Requirements and guidance
- How the requirements apply
- Targeted reforms
- Common issues

- **Duty of care** – must act fairly, honestly and in good faith
- **Registered individuals** – must understand products they recommend – s. 3.4 of NI 31-103 and 31-103CP
- **Registrants** – must take reasonable steps to ensure suitability of trades/recommendations – s. 13.3 of NI 31-103
- **Registered firms** – must oversee compliance of registered individuals
- **You** – gatekeeper of the integrity of capital markets

How do the current requirements apply?

- Client's expectations
- Cannot opt out of KYP
- KYP requirement – in addition to the suitability requirement
- KYP cannot be outsourced
- Ongoing KYP required for all products on shelf

- Consultation Paper 33-404 and CSA Staff Notice 33-319

- No explicit stand-alone KYP requirement

- Amendments being considered to explicitly require
 - Individual KYP knowledge
 - KYP policies/procedures including training
 - Consideration of similar alternative products

Presentation purpose

- Discuss common KYP issues
- Share with you our observations
- Help you in your gatekeeper role

KYP – common issues

Viability and economic status

Valuation

Background of principals

Use of funds

Product features

Compensation and other costs

Governance

PMs – documenting trade rationale

PMs – mortgage investment entities

Training sales force

- Viability assessment
- Overly simple economic calculations
- Relying on the issuer's assurances

- Conduct meaningful scenario analysis
- Conduct a viability assessment
- Question assumptions and projections
- Review financial statements and question “red flags”

- Trust units vs. Partnership units
- Financial position of underlying operating company
- Issuer price not supported by the current net asset value (NAV)
 - Accumulated losses
 - No recognition of impairments
- Issuer redeeming units at a fixed price regardless of NAV

- Assess and disclose to clients how issue price relates to NAV
- Don't allow complex structures to obscure valuation
- Disclose clearly risks relating to valuation
- Question issuer's ability to make redemptions and distributions

- Track record – management team, directors, advisory group, related parties and promoters
- Regulatory history
- Criminal background



- Thorough assessment
- Conduct a background investigation
- Regulatory investigation – CheckFirst.ca, CSA Disciplined List, and CSA Cease Trade Orders Database
- Criminal background checks
- Social media and other internet searches
- Do not sell the product if necessary

- Material change to core business
 - Change in industry sectors with different risk profiles
 - Change in nature of customer base/revenue sources
 - Change in investment concentration
- Investing in related parties
- Using new investor funds to pay-out existing investors
- Ongoing KYP obligation

- Assessing OM changes not sufficient

- Agreement obligating issuer to provide ongoing information
 - Material financial changes
 - Material changes to “core business”
 - Related party transactions
 - Ongoing financial reporting

- Stop selling the product if necessary

- Features that adversely affect risk profile
- Hurdle rate
 - Low hurdle rate
 - Resets every year
- Substantial carried interest (e.g. issuer or related parties receive >50% up to 90% of profit)
- Impact on risk profile and investor returns

- Thorough KYP assessment of features
 - Feasibility of projected/targeted returns
 - Holistic assessment of investors' share of return
 - Is the risk worth the reward?
- Are the features clearly understood by DRs?
- Are the features and risks disclosed to investors?
- Are the features and risks taken into account in suitability assessments?
- Marketing – adequate description of product, including risk?

- Selling commissions and other offering costs
- Salaries and management fees paid to related parties
- Equity participation by dealers and related parties at nominal cost
- Effect on viability

- Prominent and clear disclosure of all fees and compensation
- Assess how costs and compensation may affect returns and whether they are reasonable
- Don't sell if costs and compensation are excessive



- Voting rights held by IFM/PM or captive dealer insiders
- Investors having no or limited voting rights
- No conflicts of interest protections
 - No independent directors or trustees
 - No other controls
- These structures create significant conflicts of interest
 - Redemption requests
 - Selection of management of issuer or IFM/PM
 - Related party transactions
 - Potential wind-down

- Prominent disclosure to investors
- Significant risk factor
- Material conflicts of interest
- Does issuer have conflicts controls?
 - Independent directors and trustees
 - Independent approval of conflicts transactions
 - Investor voting or veto rights
- Do not sell product if necessary

- No documentation supporting how specific trades are suitable
- Trade within managed account mandate parameters, but PM cannot demonstrate
 - Why trade is suitable at purchase price paid
 - Up-to-date due diligence on the security
- PMs must maintain documentation supporting suitability of all trades in addition to compliance controls

- Demonstrate suitability of each trade – principles based requirement

- Best practice examples
 - Up-to-date due diligence research for every security purchased or sold – subject to suitability within managed account investment parameters
 - Memoranda with rationale for each trade

- Maintain up-to-date documentation for securities that are held for a long term

- PMs managing mortgage funds – demonstrating suitability of each mortgage is required

- Suitability failures
 - Investing outside mandate
 - Non-qualifying mortgages
 - No due diligence performed
 - Simply supporting syndicate decisions

- Related parties sourcing mortgages
 - Due diligence requirements apply in the same manner
 - Consider conflicts of interest

- Demonstrate suitability of each mortgage funded – including renewals, additional advances, and syndicate votes
- Evaluate sufficient mortgage criteria according to mortgage fund investment parameters
- Provide fair and complete disclosure of investment criteria and risks to investors
- Address conflicts of interest

- Product training required for registered individuals
- Risks
- Conflicts of interest
- Costs and compensation
- Liquidity and redemption rules
- Management and financial strength
- Revocation or rescission timelines

- Comprehensive training sessions
 - Present independent KYP information
 - Mandatory completion prior to selling
 - Test and quizzes

- Provide up-to-date information based on ongoing KYP process

- Obtain feedback from clients

Contact information

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Cyber security



Zulqer Khan, CPA, CGA, MBA
Regulatory Analyst, Registrant Oversight

What is cyber security?

Cyber security comprises technologies, processes and controls that are designed to protect systems, networks and data from cyber attacks.

Warren Buffett:

"I don't know that much about cyber, but I do think that's the number one problem with mankind."

A day on the internet - 2018

231 Billion



sent

155 Billion



Sent

6.3 Billion



viewed

5.7 Billion



Searches

4.7 Billion

GB of @ traffic

690 Million



sent

It won't happen to me!

Alberta registrants - victimized by cyber attacks



Cyber security has been identified as a priority area in the CSA
2016-2019 Business Plan.

CSA Staff Notice 11-326

*Cyber Security –
September 26, 2013*

CSA Staff Notice 11-332

*Cyber Security -
September 27, 2016*

**CSA Multilateral Staff
Notice 51-347**

*Disclosure of cyber security risks
and incidents – January 19, 2017*

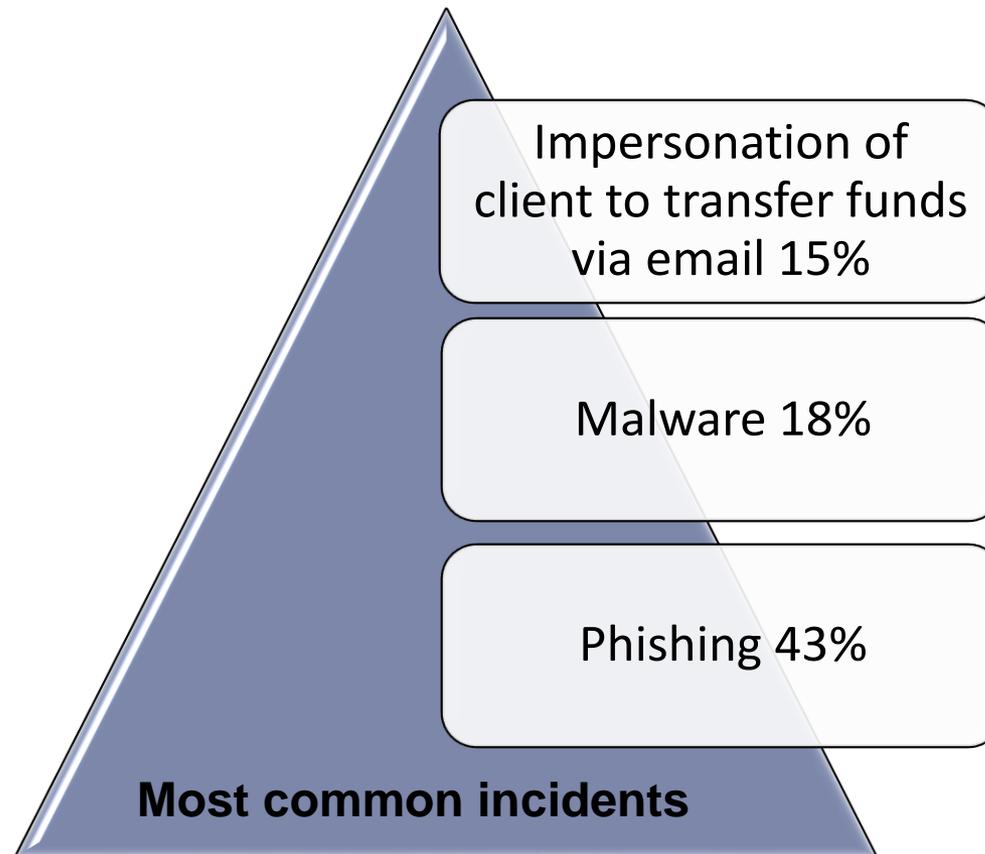
CSA Staff Notice 33-321

*Cyber Security and Social Media
- October 19, 2017*

- **Recent survey results**

- **Guidance**
 - Policies and procedures
 - Training
 - Risk assessment
 - Incident response plan
 - Due diligence – service providers
 - Data protection
 - Insurance

Approximately **51%** of firms experienced a cyber security incident in the year surveyed.



- Electronic communications
- Firm-issued electronic devices
- Loss/disposal of electronic devices
- Public electronic devices/public internet connections
- Detection of unauthorized activity
- Software updates
- Third-party vendors/service providers
- Reporting of incidents

- **Employees** – often the first line of defense
- **Training** – critical
- **Evolving landscape** – frequent training required



- **Risk management** - required by law

- **Cyber security risk assessment**
 - At least annually
 - Inventory critical assets and data
 - Identify and assess cyber threats, vulnerabilities and consequences
 - Assess adequacy of controls and response plan

92% of firms engaged third party service providers

- **Third party's security practices** - evaluate and assess
- **System access** - limit third party access
- **Third party service contracts** - include cyber security clauses
- **Cloud services** - understand security practices and have back-up plan in case not accessible

- Incident Response Plan
- Data Protection
- Insurance

CSA staff will continue to review the cyber security practices of firms through compliance reviews





Cyber Security & Alberta Organizations

Presented by Jean Hernandez

Agenda

1. Cyber threat landscape
2. How to protect your organization
3. Where to learn more

Cyber threat landscape

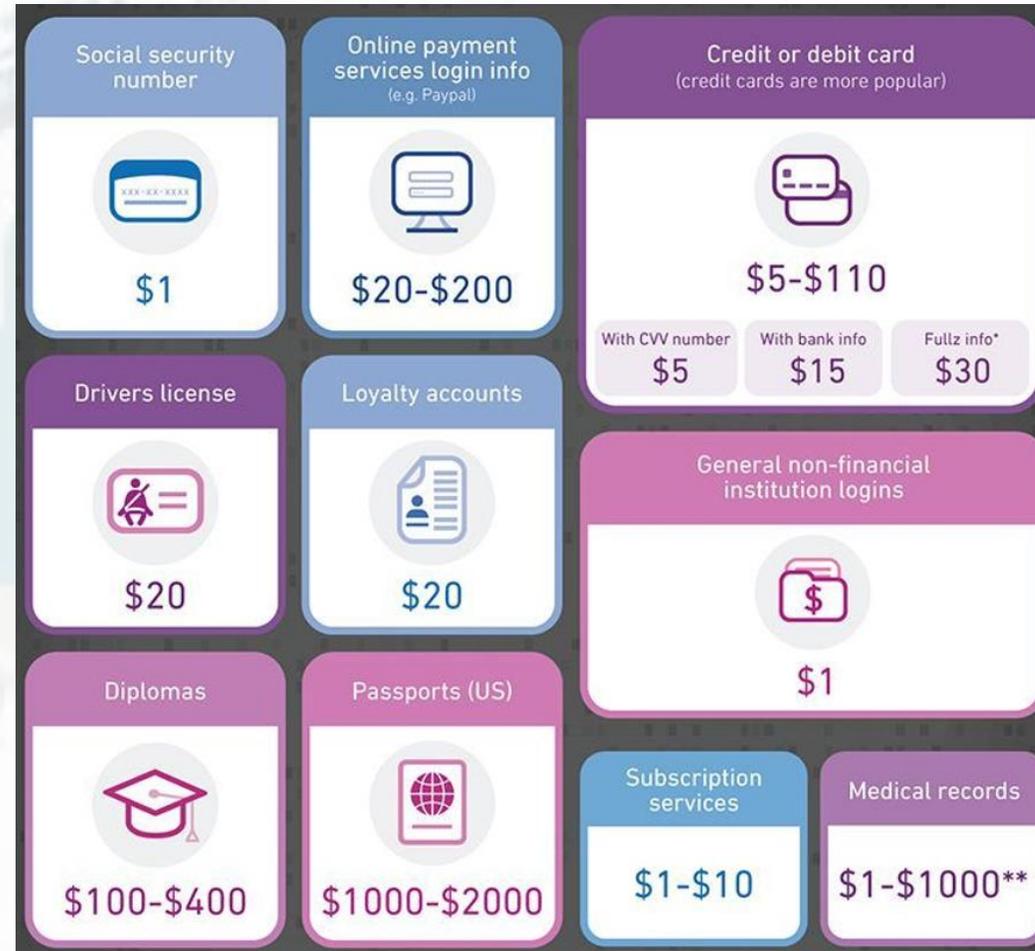
Cybersecurity is often in the news.

The new reality: increased threats and increased scrutiny

- **Grant McEwan University (2017)**
 - Defrauded \$11.8M in on-line phishing scam
- **Equifax (2017)**
 - Theft of personal data as a result of a software flaw
- **WannaCry Attack (2017)**
 - Encryption of data through ransomware attack on 200,000 outdated Microsoft-operated computers in 150 countries
- **University of Calgary (2016)**
 - Ransomware held staff email hostage until \$20,000 ransom was paid

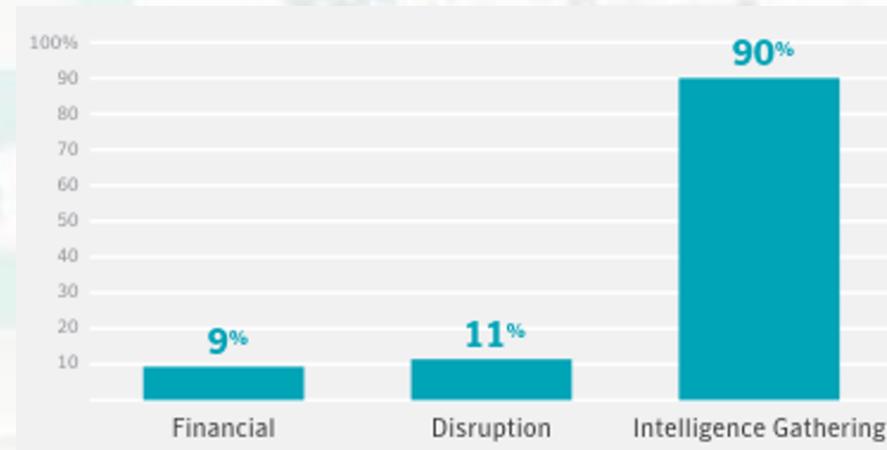
Your identity is a steal on the Dark Web.

Here are what the most common pieces of information sell for

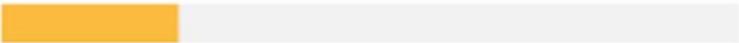


Targeted attack motives

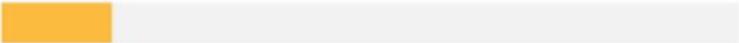
Known motives of targeted attack groups.
The majority of group are focused on intelligence gathering.



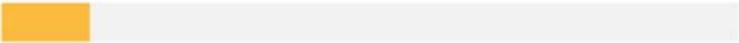
Who are the victims?

24% 

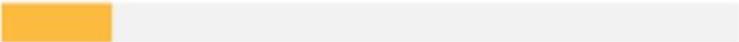
of breaches affected financial organizations.

15% 

of breaches involved healthcare organizations.

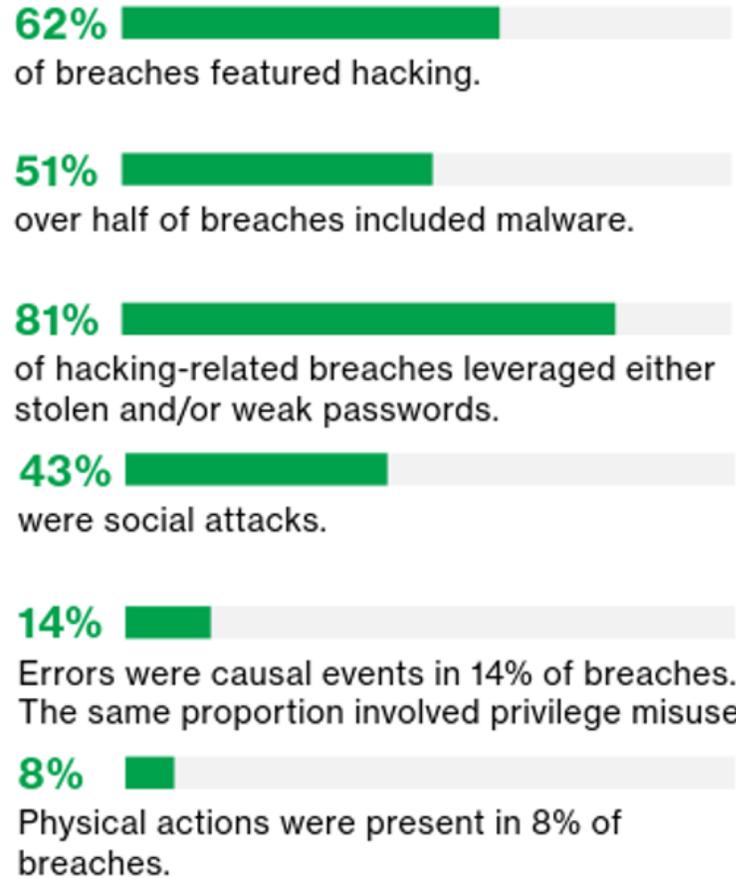
12% 

Public sector entities were the third most prevalent breach victim at 12%.

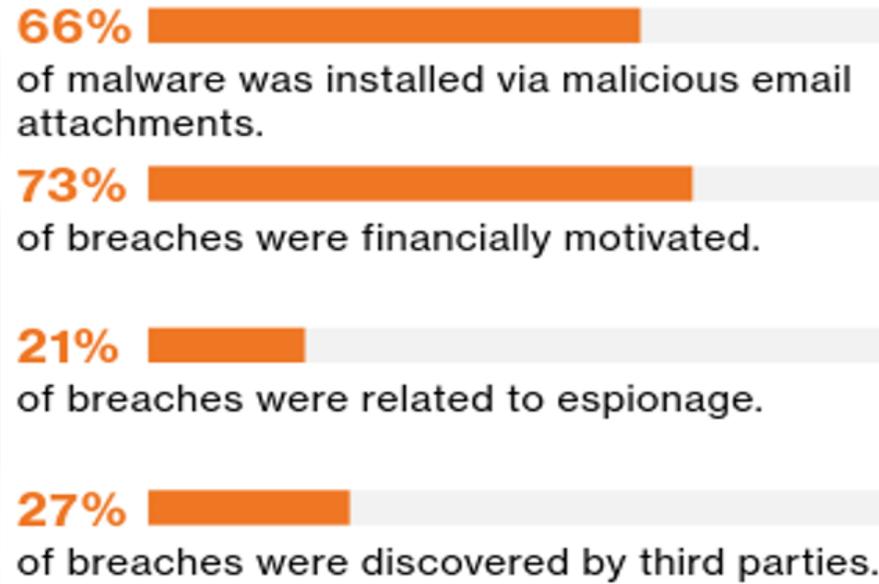
15% 

Retail and Accommodation combined to account for 15% of breaches.

What tactics do they use?



What else is common?



Does this happen at your organization?

- Someone uses the same **password** for all of their accounts
- Someone wants to **finish up a project at home** and sends confidential information to insecure home computer
- Someone takes a work laptop to use at a meeting at a **Starbucks**, using their unsecure wifi connection
- Someone checks their **personal email** on a company computer
- Someone **clicks on a link** in an email that looks like it came from their bank or a friend
- Your IT guy **misses a virus protection installation** on one of your company's computers

Who's your most dangerous offender?



What is phishing?

- Attempt (usually through email or other electronic communication like text) to **obtain sensitive information** such as usernames, passwords, and credit card details, often for malicious reasons, by disguising as a trustworthy entity.
- Phishing emails may contain links to websites that distribute **malware**.

Sample phishing email

NETFLIX

[Your Account](#) | [Queue](#) | [Help](#)

Your Account Has Been Suspended

Dear Netflix,

We are sending this email to let you know that your credit card has been expired. To update your account information, please visit [Your Account](#).

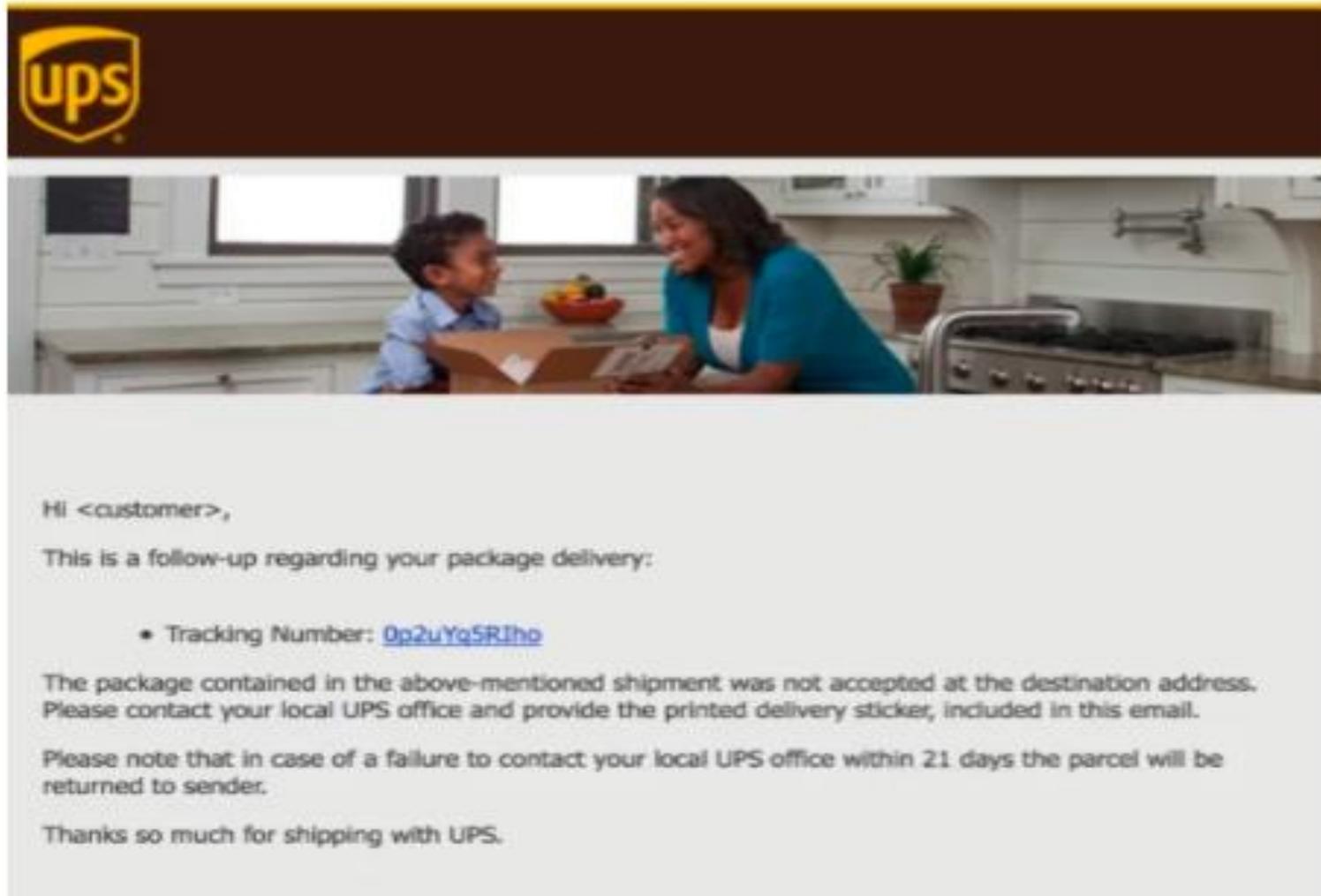
-Your friends at Netflix

Sample phishing email



©Copyright Canada Revenue Agency. All rights reserved.

Sample phishing email



Sample phishing email



PayPal

We need your help

Your account has been suspended, as an error was detected in your informations. The reason for the error is not certain, but for security reasons, we have suspended your account temporarily

We need you to update your informations for further use of your PayPal account.

[Update your information](#)

You are currently made disabled of :



Adding a payment method
Adding a billing address

Sending payment
Accepting payment

Please do not reply to this email. We are unable to respond to inquiries sent to this address. For immediate answers to your questions, visit our Help Center by clicking "Help" located on any PayPal page or email.

Copyright © 2016 PayPal, Inc. All rights reserved. PayPal is located at 2211 N. First St., San Jose, CA 95131.

Sample phishing email



Refund Notification

Due to a system error you were double charged for your last order, A refund process was initiated but could not be completed due to errors in your billing information

REF CODE:2550CGE

You are required to provide us a valid billing address

[Click Here to Update Your Address](#)

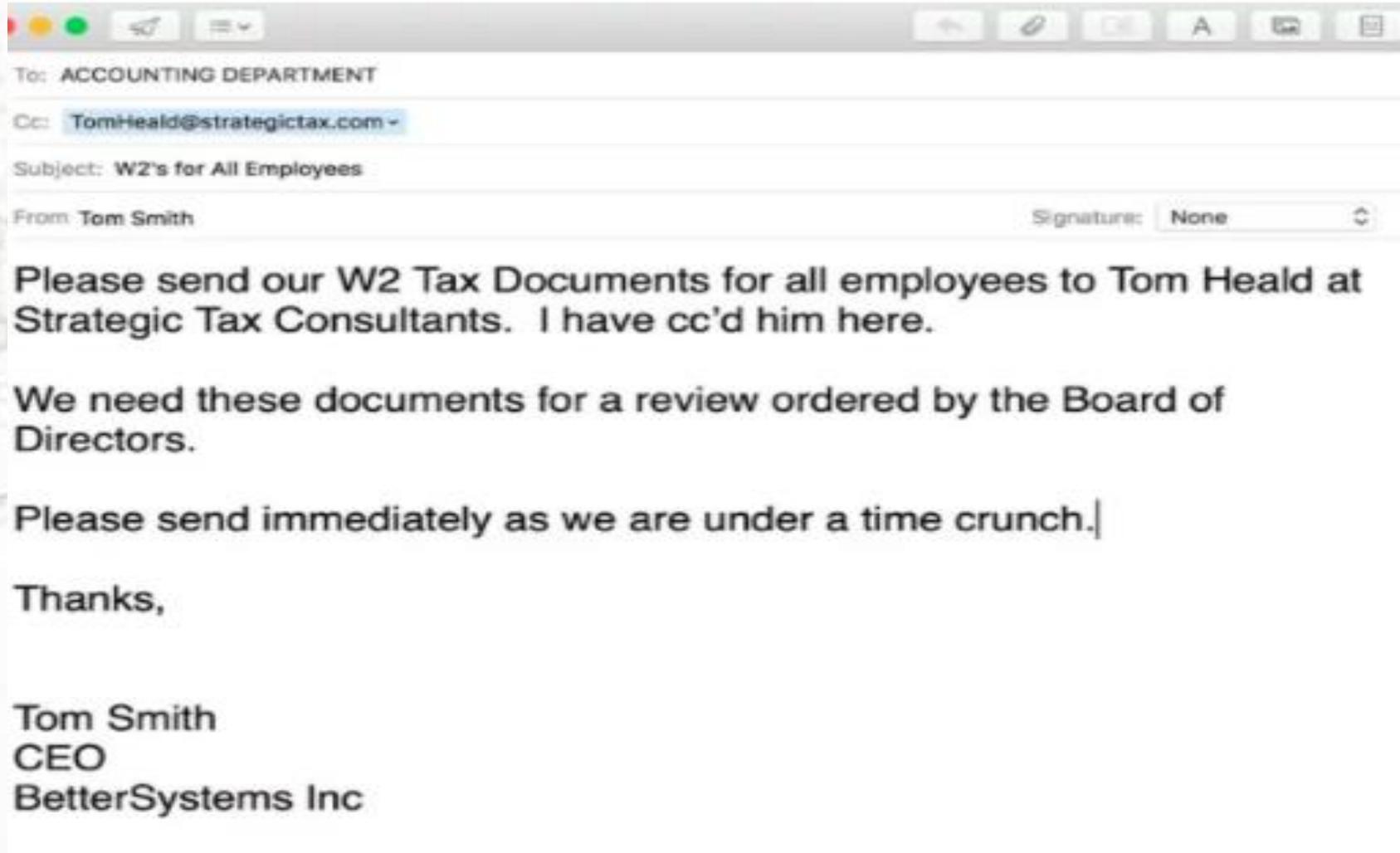
After your information has been validated you should get your refund within 3 business days

We hope to see you again soon.

[Amazon.com](#)

Email ID: [REDACTED]

Sample phishing email



Sample phishing email

From: [REDACTED]
Sent: Tuesday, March 28, 2017 1:21 PM
To: [REDACTED]
Subject: INSTRUCTION FOR WIRE TRANSFER

Hi [REDACTED]

I need you to process a wire transfer to a new vendor.
please let me know when you can get it done

Thanks
[REDACTED]

Sample phishing email

Urgent Request

Inbox x



Mr. [Redacted]

7:50 AM (1 hour ago)



to me

Alanna

I want you to send me the list of W-2 copy of employees wage and tax statement for 2015, I need them in PDF file type, you can send it as an attachment. Kindly prepare the lists and email them to me asap.



Best way to avoid phishing

- Pause. Read. Think.
- Ask yourself:
 - Is this **normal behavior**?
 - Would I normally receive this type of message at this **time of day**?
 - Is this typical-sounding **language** from this individual?
- If in doubt, pick up the phone and call the sender instead.
- No professional organization will ever ask you to reveal personal or financial information over email or by going to a link.

What is malware?

- Short for “malicious software”
- Umbrella term that includes:
 - Viruses
 - Ransomware
 - Spyware
 - And others

Rapidly growing cyber black market

Dark Web/Dark
Net/Deep Web



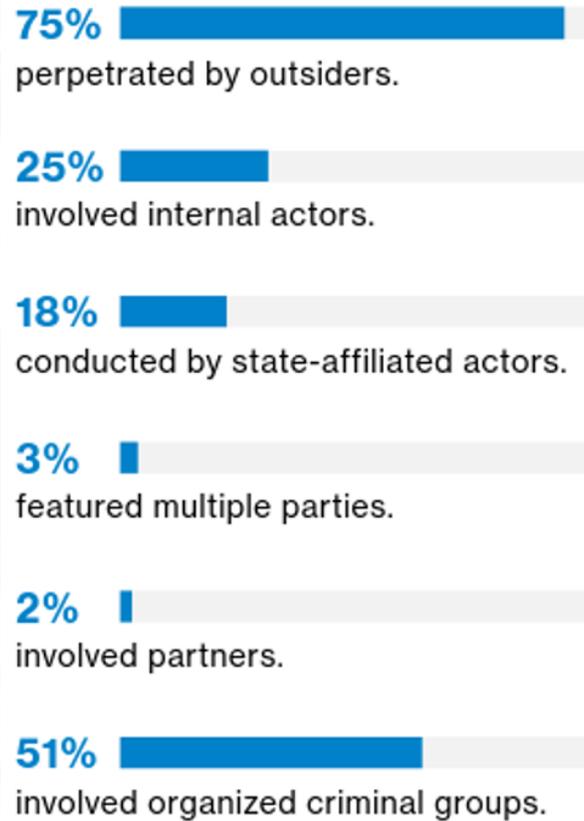
Cyber Black
Market



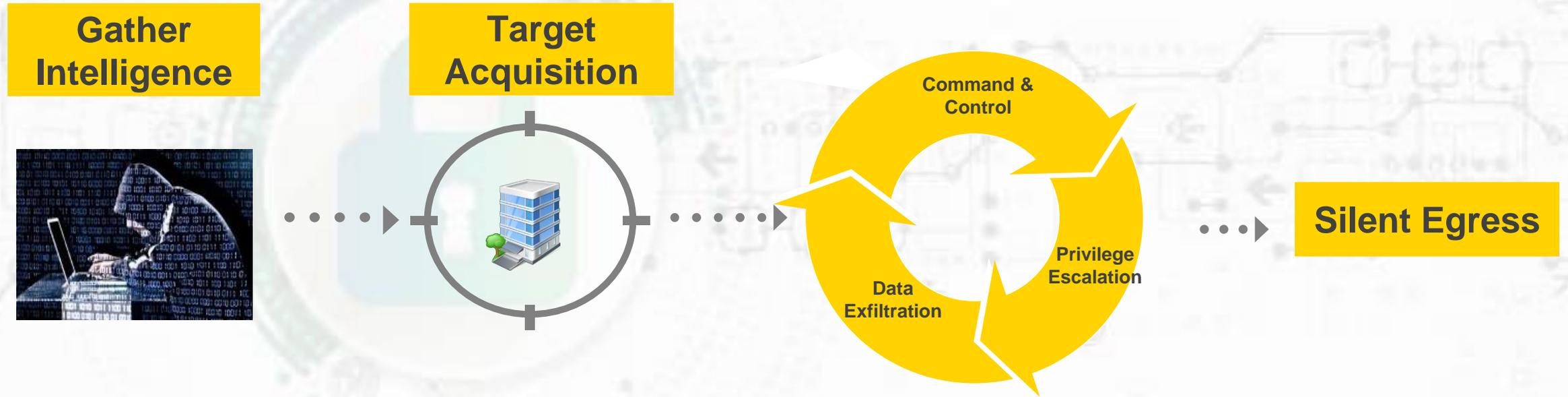
Bitcoin



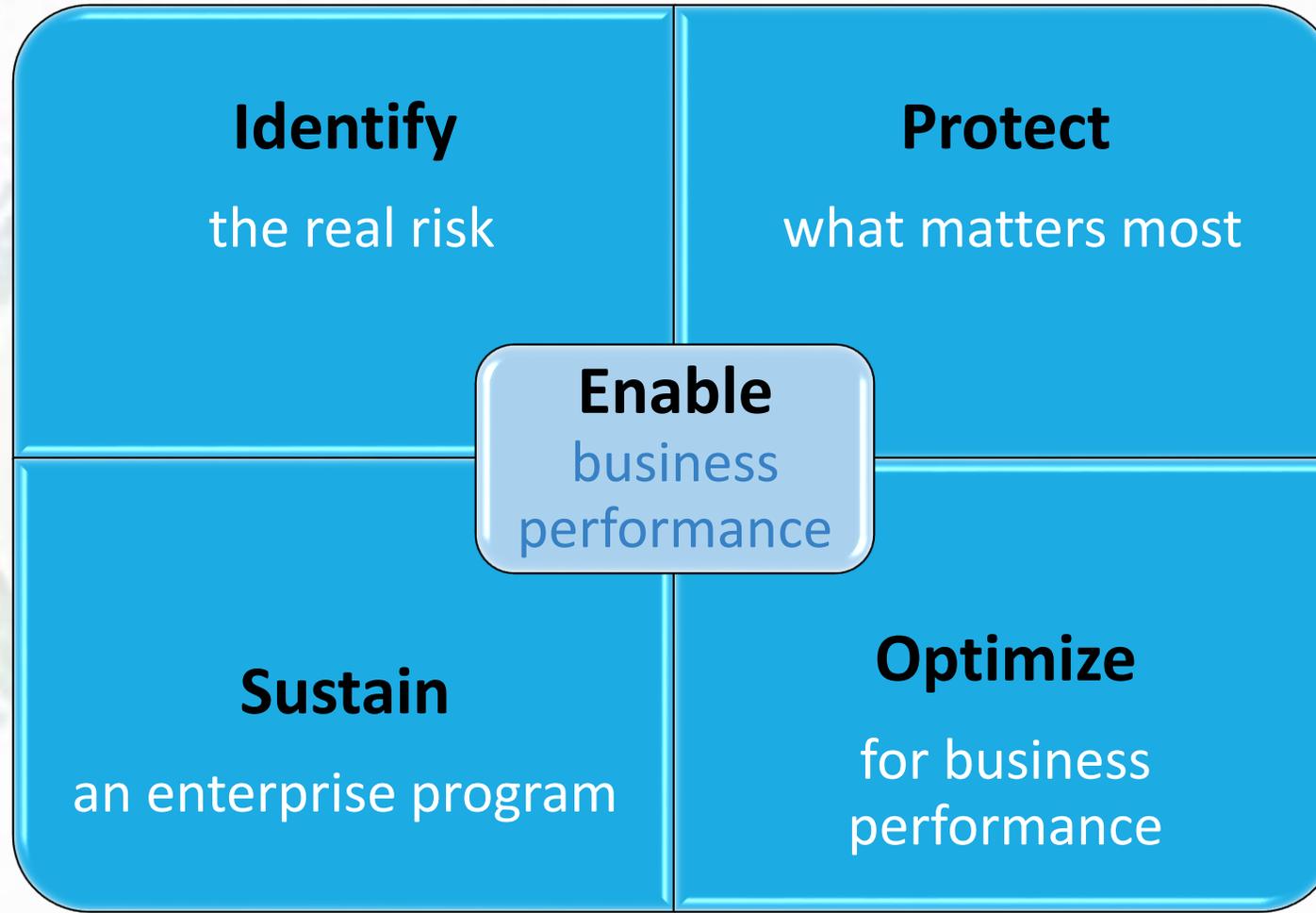
Who is behind the breaches?



Typical attack life cycle

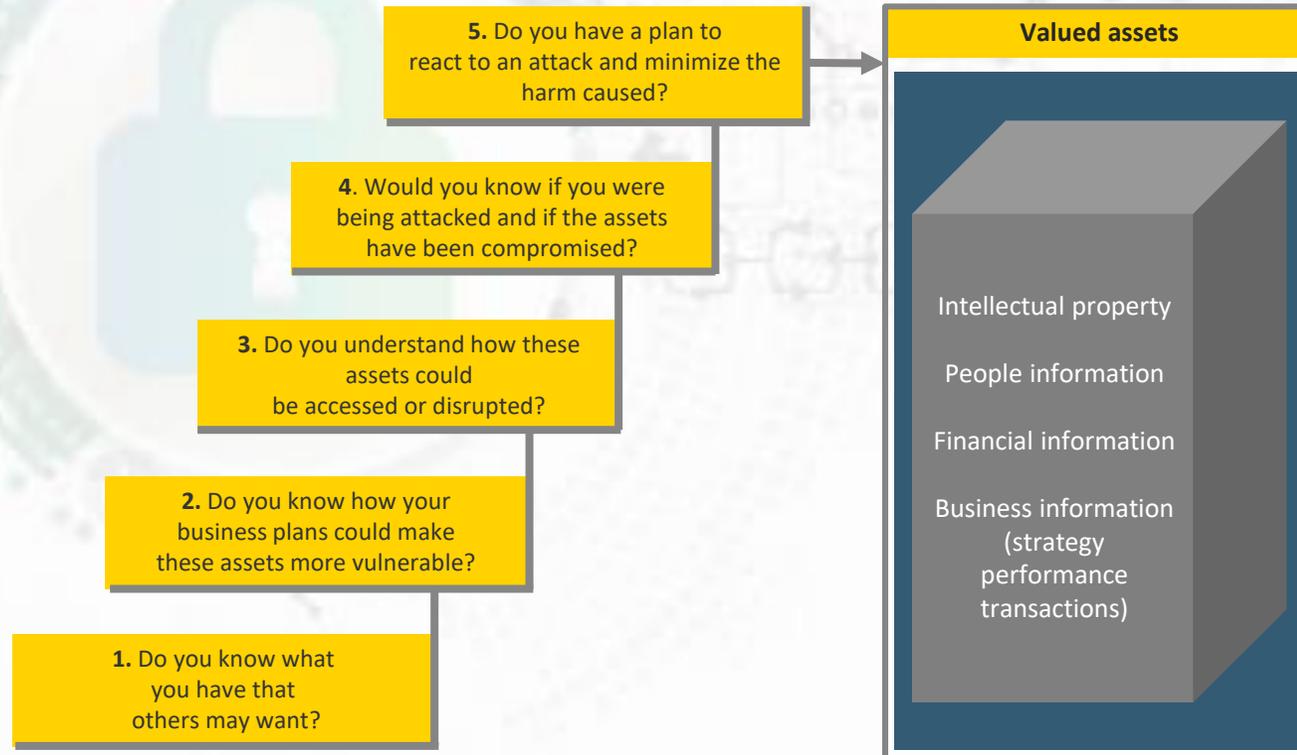


Cyber security program

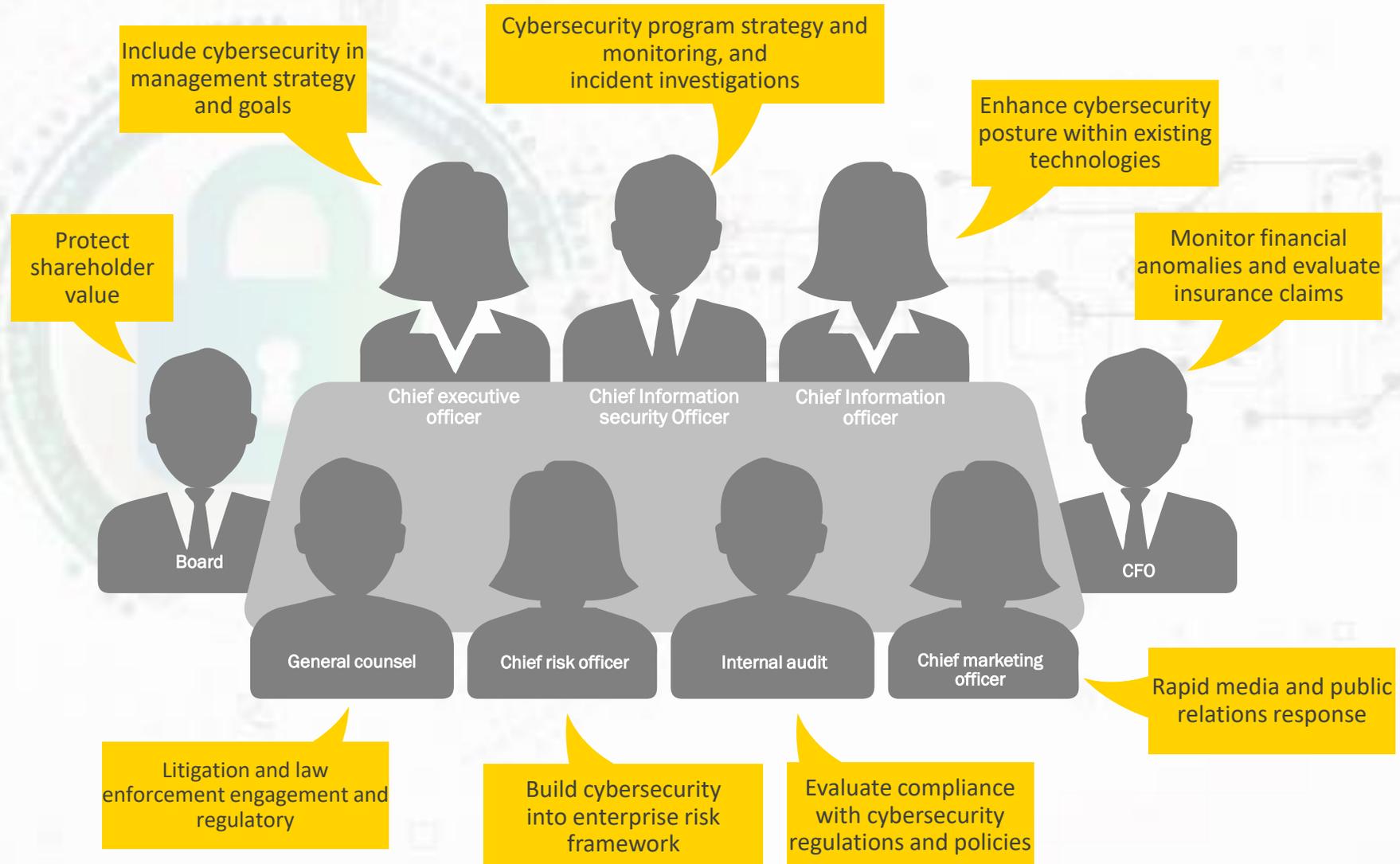


Protect what matters the most

Being attacked is unavoidable, so how prepared are you?
Can you answer “yes” to these five key questions?



Embed cybersecurity into every role to protect your most critical assets



Where to start

- Identify your assets enabling critical business processes
- Identify your sensitive data
- Establish a security controls baseline
 - Malware protection software on computers and servers
 - Regular patch management practices (infrastructure and applications)
 - Network security controls (internet access and e-mail protection)
 - Identity and access management controls
 - Regular back-ups and recovery testing

Threat detection and response

- Define, implement and sustain a cyber incident response process
- Define, implement and sustain security monitoring capabilities
- Define, implement and sustain vulnerability identification and risk mitigation processes

Key attributes of an Incident response plan



Want to learn more?

- Canadian Cyber Incident Response Centre (CCIRC)
 - <https://www.publicsafety.gc.ca/cnt/ntnl-scrn/cbr-scrn/ccirc-ccirc-en.aspx>
- Center for Internet Security (CIS)
 - <https://www.cisecurity.org/controls/>
- National Institute of Standards and Technology (NIST)
 - <https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-53r4.pdf>

Employee training options

InnoTech College:

- (ISC)2 Certifications
 - Certified Information Systems Security Professional (for operational leaders)
 - Systems Security Certified Practitioner (for IT professionals)
- Arcitura Certifications
 - Cloud Architect
 - Cloud Security

Other Educational Institutions:

- SAIT - IT Security Certificate
- NAIT – System Security Certificate

Questions?

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Registrant Outreach and Education Seminar



The Metropolitan Conference Centre
May 29, 2018