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MFDA Bulletin

Compliance

For Distribution to Relevant Parties within your Firm

Second Round of Compliance Examinations

The purpose of this Bulletin is to advise Members that MFDA staff have commenced the second round of compliance examinations. These examinations will include review of deficiencies identified during the initial examination and resolution of these deficiencies.

Members are reminded of their obligation to employ the necessary staff and resources in order to ensure that deficiencies identified during their first compliance examination are resolved.

Common Deficiencies

On February 5, 2004, the MFDA issued Bulletin #0056-C — *Common Deficiencies Noted During On-Site Examinations of Members* — which included deficiencies commonly identified during compliance examinations. The following is a list of common deficiencies identified in the period since the issuance of Bulletin #0056-C:

Trading and Supervision

- Members either did not conduct branch reviews at all or there was insufficient follow-up of issues raised during branch reviews (*Policy No. 2*);
- Branch level supervision was not conducted in accordance with MFDA Policy No. 2 (*Policy No. 2*);
- Updates to Know Your Client (“KYC”) information were not reviewed and approved by branch managers or other qualified individuals (*Policy No. 2*);

- Trade blotter used for daily trade supervision did not identify leveraged trades or trades executed under a limited trading authorization (“LTA”) and/or did not contain all of the information required under MFDA Rule 5.1(a) (*Policy No. 2 and Rule 5.1(a)*);
- Trade supervision was not performed on a daily basis and/or there was no evidence of inquiries made, follow up on inquiries made, or the date upon which the reviews took place (*Rule 2.2.1(c) and Policy No. 2*);
- An annual report on the status of compliance was not provided to the Member’s board of directors (*Rule 2.5.2(b)*);
- The Member could not produce evidence of client trade instructions (*Rule 5.1(b) and MFDA Member Regulation Notice MR-0035*);
- Approved Persons executed trades in labour sponsored funds without meeting the proficiency requirements (*Rule 1.1.5(a)*);
- The Member did not designate an alternate compliance officer (*Rule 2.5.2(c)*);
- The Member did not provide clients with a leverage disclosure document at the time of account opening and/or at the time clients entered into leveraged transactions (*Rule 2.6*);
- The Member did not maintain a log of client complaints or the log maintained by the Member did not contain all of the required information (*Rule 2.11 and Policy No. 3*);
- The Member did not provide clients with a client complaint information form at the time of account opening and/or at the time a complaint was received (*Member Regulation Notice MR-0020 and Subsection 24.A.5 of MFDA By-Law No. 1*);
- The Member did not respond to one or more client complaints in writing, either to acknowledge receipt of the complaint or convey the results of its investigation (*Policy No. 3*).

New Accounts

- New Account Application Forms (“NAAFs”) were not on file for all client accounts (*Rule 2.2.1 and Rule 2.2.2*);
- NAAFs were incomplete and did not include sufficient KYC information required to ascertain suitability of trades (*Rule 2.2.1 and Rule 2.2.2*);
- New accounts were either not approved or were not approved in a timely manner (*Rule 2.2.3*).

Registration

- The Member failed to notify the MFDA of changes in Directors or Officers or other material changes in registration (*Rule 1.2.5 and Bulletin No. 0082-M*);
- The Member had one or more branch or sub-branch locations that were not registered or were registered as a sub-branch when they should have been registered as a branch (*By-Law No. 1*).

Approved Persons

- Approved Persons who are considered agents by the Member had not signed an agent agreement or a copy of the signed agreement could not be located (*Rule 1.1.5(k)*);
- The Member’s agent agreement did not conform to one or more of the requirements listed in MFDA Rule 1.1.5 (a) to (j) and there was no evidence of an override acknowledgement in the Approved Person file;

- In cases where Approved Persons are employed in another gainful occupation, the Member did not provide clients with disclosure that any activities related to such other gainful occupation are not the business nor the responsibility of the Member (*Rule 1.2.1(d)(vi)*).

Client Communications

- The content of client account statements did not conform to MFDA Rule 5.3.3;
- Client account statements were not sent to clients in the time frames outlined in MFDA Rule 5.3.1;
- The Member did not provide clients with adequate disclosure of referral arrangements (*Rule 2.4.2(b)(iv)*).

Advertising and Sales Communications

- One or more advertisements were considered misleading to clients (*Rule 2.7.2*);
- Approved Person websites were not reviewed and approved by the designated person (*Rule 2.7.3*).

Financial and Operational Requirements

Internal Controls

- Members did not prepare reconciliations of nominee name assets to third party information on a monthly basis (*Policy No. 4 and Internal Control Policy Statement 4*);
- There was no evidence of management review and approval of the operating and/or trust bank account reconciliations (*Policy No. 4 and Internal Control Policy Statement 4*);
- There was no evidence of supervisory review and approval of the monthly nominee name security positions reconciliations (*Policy No. 4 and Internal Control Policy Statement 4*);
- There was no evidence of management review and approval of the working papers used to prepare the Financial Questionnaire and Report (“FQR”) (*Rule 2.9*);
- Adequate procedures were not in place to ensure all financial related matters are communicated to the finance department for the purposes of reporting on the FQR (*Rule 2.9*);
- Written policies and procedures did not adequately address the minimum requirements of MFDA Rules and Policies (*Member Regulation Notice MR-0008 and Policy No. 4*);
- Custodial, Trustee/Agent, Referral and Service Agreements that the Member has entered into did not satisfy minimum MFDA requirements (*Rule 3.3.3(b), Rule 1.1.3(e) and Rule 5.1*).

Trust Accounts

- The Member’s mutual fund trust account did not bear interest (*Rule 3.3.2(f)*);
- The Member did not distribute interest earned in the mutual fund trust account (*Rule 3.3.2(h)*);
- The Member had not advised its financial institution in writing of the requirements surrounding the trust accounts (*Rule 3.3.2(d)*);
- Fees and services charges were paid out of the trust account (*Rule 3.3.2(g)*).

Departures from Financial Requirements

- Unresolved differences in nominee name and trust accounts were not reported on Statement B line 12 and 13, respectively (*Notes and Instructions to Statement B of the FQR*);
- Cash method of accounting (i.e. settlement date) was used when accrual accounting (i.e. trade date) is required (*General Notes and Definitions of the FQR*);
- Client assets were not properly segregated (*Rules 3.3.2(a) and 3.3.3(a)*);
- Debit balances related to NSF cheques, errors, or cancellations were not properly reported on Statement A line 18 and Schedule 2 (*Notes and Instructions to Statement A of the FQR*);
- Commissions payable were incorrectly netted against commissions receivable (*General Notes and Definitions of the FQR*);
- Client cash held in trust was not reported on Statement A lines 2 and 23 (*Notes and Instructions to Statement A of the FQR*);
- Securities held by the Member in its capacity as agent for the trustee were not included in the minimum insurance calculation (*Notes and Instructions to Schedule 4 of the FQR*);
- Assets under administration were not reported accurately at the FQR date (*Notes and Instructions to Statement D of the FQR*).

Referrals to the Enforcement Department of the MFDA

In Bulletin #0056-C, the MFDA listed a number of deficiencies which may be grounds for immediate referral to the Enforcement Department of the MFDA. The types of deficiencies that have been identified by MFDA staff during the first round of examinations and other routine compliance work that resulted in a referral to the Enforcement Department are as follows:

- Churning or excessive trading in client accounts;
- Failure to implement a two-tier supervisory structure in accordance with Policy No. 2;
- Discretionary trading in client accounts or the existence of pre-signed trade order forms in client files;
- Conflicts of interest in the sale of exempt securities;
- Unresolved suitability issues;
- Approved Persons engaging in outside business activities or personal financial dealings that raised significant conflict of interest concerns or caused client harm;
- Trading in client accounts in jurisdictions where the Approved Persons or the Member is not registered.

Going forward, in addition to the deficiencies listed above and in Bulletin #0056-C, any deficiencies that were reported in the Member's initial compliance examination report that have not been rectified will be considered for referral to the Enforcement Department of the MFDA.