



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

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MFDA Bulletin

Policy

For Distribution to Relevant Parties within your Firm

Principal Protected Notes (“PPNs”)

Background

In July 2006, the Canadian Securities Administrators (“CSA”) issued CSA Notice 46-303 – *Principal Protected Notes* which discussed key concerns relating to the distribution and sale of PPNs. The Notice identified know-your-client (“KYC”) and suitability obligations as a critical aspect of investor protection that should apply to sales of all PPNs by registrants. Further updates on this issue were provided in CSA Notice 46-304 – *Update on Principal Protected Notes* (issued July 2007) and CSA Notice 46-305 – *Second Update on Principal Protected Notes* (issued August 2008).

CSA Notice 46-304 stated that the CSA had initiated discussions with the MFDA regarding changes to MFDA Rules that would confirm the application of KYC and suitability obligations to dealings in PPNs by MFDA Members and their representatives.

The CSA Notices define a PPN as:

“...an investment product that offers an investor potential returns based on the performance of an underlying investment and a guarantee that the investor will receive, on maturity of the PPN, not less than the principal amount invested. For the purpose of this notice, PPNs include the instruments commonly described as market-linked GICs and market-linked notes.”

CSA Request

The CSA recently requested that the MFDA take appropriate action to ensure that KYC and suitability obligations apply to all dealings in PPNs by Approved Persons of its Members. The CSA confirmed their expectation that the MFDA enforce KYC and suitability obligations on the sale of any PPN, whether or not it falls within the definition of a “security” in all jurisdictions.

This would include PPNs that are deposit instruments currently sold by Approved Persons outside an MFDA Member.

In addition, the CSA expressed the view that KYC and suitability obligations should apply to all dealings in PPNs by Approved Persons of MFDA Members, regardless of whether or not the Approved Person is also an employee of a bank. The CSA advised that all MFDA Members and Approved Persons, as registrants under securities legislation, must comply with their KYC and suitability obligations in selling all types of investment products.

Rule Amendments under Consideration

In order to comply with the CSA request, the MFDA will consider appropriate Rule amendments to require the sale of **all** PPNs by Approved Persons, including dually employed Approved Persons, to be conducted through the Member firm and hence subject to product due diligence, KYC and suitability obligations under MFDA Rules.

The proposed Rule amendment would apply the definition of PPNs used in the CSA Notices as set out above.

Request for Comments

MFDA staff will be developing a discussion paper for consideration by the MFDA Policy Advisory Committee. In order to assist MFDA staff in developing a proposal, comments from the industry on the impact and implications of the amendments would be appreciated. In particular, it would be helpful if Members could provide information regarding the scope of PPN activity conducted outside the Member firm including the number of Approved Persons currently selling PPNs outside the Member and the market value of such products. Please forward your comments to Paige Ward, Director of Policy and Regulatory Affairs (pward@mfd.ca) by **February 20, 2009**.

Further Information

To view the CSA Notices referenced to in this bulletin, go to the Ontario Securities Commission's website at:

http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/rrn_part4_index.jsp

If you have any questions regarding the CSA Notices or the CSA's position on this issue, please contact the CSA staff contacts listed in the Notices.

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