



September 12, 2008

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Corporate Secretary  
Mutual Fund Dealers Association of Canada  
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And

Sarah Corrigall-Brown, Senior Legal Counsel  
British Columbia Securities Commission  
701 West Georgia Street, P.O. Box 10142,  
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Vancouver, British Columbia  
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Dear Sirs/Mesdames:

We are writing to you on behalf of the Association of Canadian Compliance Professionals ("ACCP") and its Members to provide our comments with respect to the proposed amendments to MFDA Rule 2.2 and MFDA Policy 2 published on June 13, 2008.

The ACCP is an organization representing over 150 compliance professionals across Canada and operates chapters in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, and Quebec. The ACCP's constituency is comprised of compliance professionals employed by member firms of the Mutual Fund Dealers Association of Canada ("MFDA"). As such, our Members represent the individuals who undertake to carry out the oversight responsibilities of their firms for client accounts, suitability, and account supervision. We therefore feel that we offer an important and unique perspective on the impact of the amendments proposed.

We also note that the *Suitability Guidelines* issued in *MFDA Member Regulation Notice MR-0069* (the "Notice") also prescribe standards for Members with respect to know-your-client ("KYC") and suitability obligations. Since the Notice will be updated to the

extent that amendments to the draft Rule and Policies necessitate changes to the Notice, we also submit our comments on the Notice herein.

We commend the MFDA for the consultative approach that they have taken with respect to the proposals and for meeting with the ACCP. We believe that the dialogue undertaken was constructive and our comments herein represent our understanding of the issues discussed.

We respectfully submit our detailed comments below with respect to the specific sections of the proposals.

## 1. Transition Periods

As duly recognized by the MFDA, many of the changes in the proposals will require system development and the implementation of new and modified business processes. We note that the proposals will require significant system development including those items listed in the high level summary below.

- a) KYC Updates – Functionality to identify the last date that KYC fields were updated and the development of new reports for KYC update approvals
- b) Net Worth – Fields to collect liquid assets, fixed assets, and liabilities and modification to display screens, reports, and system generated KYC forms
- c) Joint Accounts – Fields to collect information for joint holders on account level KYC and modification to display screens, reports, and system generated KYC forms
- d) KYC Definitions – Fields to collect definitions for KYC terms for system generated KYC forms
- e) Incomplete KYC – Functionality to identify, report, and freeze accounts with incomplete KYC
- f) Inconsistent KYC – Functionality to identify and report accounts with inconsistent KYC
- g) Similar KYC – Functionality to identify and report accounts with similar KYC
- h) Account KYC – Functionality to move certain KYC values to the account level from the client level, or otherwise deactivate client level values where required
- i) Product Risk – Industry development to correct invalid information currently provided by product suppliers as to “product type” in order to identify exempt securities from prospectus mutual funds and system development to generate

new exception reports. Functionality to “map” product risk (e.g. 6 values) to client risk tolerance (e.g. 3 values) on a conservative basis.

- j) Time Horizon – Fields to collect information on product time horizon and DSC schedules and the development of new exception reports
- k) Suitability Assessment – Functionality to move Members from assessment methods deemed inappropriate including “Weighted Average Risk” and “Split Product Risk Ranking” assessments. While we note that the MFDA asserts that these are not changes to existing requirements, we point out that considerable development will be required in order to bring Members to full compliance.
- l) Suitability Triggers – Functionality to generate the necessary exception reports for suitability reviews required for the new suitability triggers (i.e. transfers-in, re-assignment to a new Approved Person, material change)
- m) Branch Office and Head Office Supervision – New fields, exception reports, and specific reporting filters to identify trades for review including trade amounts (e.g. \$5,000), product risk (e.g. moderate-high or high), product type (e.g. exempt securities), accounts of family members of Approved Persons, etc.
- n) Trading Trends Reviews – Several new reports with specific reporting filters will need to be developed. We note that significant development will be required in order to satisfy the trading trend proposals.
- o) Leverage Suitability – Fields and flags in order to generate the reporting required

Given that the scope of system development required is significant and will demand business requirements, technical design, development, and user testing, and Members will also require time to develop forms, policies, procedures, and implementation plans, we make the following recommendations with respect to transition periods:

#	DESCRIPTION	TRANSITION PERIOD
1	System development	1 year from rule/policy approval
2	Member implementation	1 year + 3 months from rule/policy approval
3	New Accounts/KYC/CRM Documents	The first “trigger” (trade, transfer, reassignment of AP, material change) following 1 & 2 above

We note that while the proposals state that “the MFDA will consider transition periods for the implementation of the amendments” it also goes on to state that “Members will also be expected to create processes to ensure that existing accounts comply with the new requirements.” We suggest that this is impractical and we request further

clarification. For example, how can a Member be expected to collect the liquid assets, fixed assets, and liabilities of a client and assess suitability against those values when the back office system does not have the necessary fields for the collection of this data into the system? Mutual fund dealers, as are other market participants, highly dependent on technology to support the business processes they employ to carry out their operations. We submit that Members should be granted appropriate transition periods and should not be held to compliance with the new requirements until such time that systems can be delivered to enable their compliance.

## **2. Section 2.2.3 and Policy 2(II) – New Account Approval**

We note that the proposed amendments would change the requirement to approve new accounts from “within one business day of any initial transaction” to “within one business day after the date that the account is opened”. Our issues with this proposal are set out below.

- a) We suggest that this proposal will result in inefficiencies in the account approval process. Members currently approve the new account in tandem with the initial transaction, thus resulting in a comparison of the essential facts of the client with the essential facts of the order. We submit that account approval, absent the details of the initial transaction, represents an unnecessary step and results in an incomplete review that would warrant a second review at the time of the transaction.
- b) We request clarity as to the “date that the account is opened”. Does this equate to the date that the account is entered into the Member’s back office system? We note that account approval prior to entry to the back office system also imposes inefficiencies since a second review for accuracy, pursuant to Section II (7) of the proposed Policy, would also be required.

We submit that the requirement to approve new accounts should remain “within one business day of any initial transaction” in order to retain efficiencies in the account approval process, effect complete reviews including all essential facts of the client and the order, and to best satisfy the purpose of the account review. We note that these issues with respect to account approvals were brought forward at our meeting and we appreciate that the MFDA agreed to consider this matter further as a result.

## **3. Low Risk Exceptions**

Section 3(C) of MR-0069 states that where a percentage method for recording risk tolerance is employed, “a trade that results in an account with a greater percentage of low, medium or high risk investments than indicated on the KYC form should be flagged for a suitability review.” We submit that the requirement to assess accounts that are under exposed to risk is impractical and represents a wholesale change to suitability assessment requirements and practices. It is our view that “risk tolerance” represents

the client's tolerance to the risk they are willing to accept and not the client's expectation of the risk they should have exposure to. Normal industry practice would not prescribe that accounts that are conservatively invested below the risk tolerance on the KYC be investigated, specifically during daily trade reviews. What then would be the remedy? Sell lower risk investments and buy higher risk investments to align the account? This would seem contradictory to investor protection obligations. Normal industry practice is to focus on accounts where the KYC risk tolerance has been exceeded.

During discussions with the MFDA, it was clarified during the meeting that Members would not be required to assess accounts during the daily trade review process for trades that result in a risk allocation lower than the stated KYC. We request confirmation of our understanding from the meeting.

#### **4. Suitability of Exempt Products**

Section 2(B) of MR-0069 states that "A Member may distribute certain exempt securities such as hedge funds, limited partnerships or private notes or debentures for which there is not a prospectus. In these circumstances, these securities should be considered high risk." We submit, as discussed in our meeting with the MFDA, that not all exempt securities should be considered high risk. We are of the view that Members should be permitted to rank certain exempt products, including those that do not have high volatility or employ strategies such as leveraging and short selling, and provide liquidity (e.g. redemption on demand provisions) and security holder rights similar to prospectus funds, at appropriate risk rankings. Where the product is a "mutual fund like security", as per language used in *BC Interpretation Note 33-701*, and it includes the necessary provisions in their offering documents to address the issues of shareholder rights and liquidity, we submit that Members should be allowed to exercise discretion in ranking the product's risk. We feel that the MFDA appeared to agree with this perspective during our discussions and we request confirmation of our understanding from the meeting.

#### **5. Leverage Suitability – Net Worth**

Section 4(C) of MR-0069 states that "an investment loan should not exceed 30% of a client's net worth and 50% of a client's liquid net worth". Since Members generally use either "net worth" or "liquid net worth", often times in conjunction with the total debt servicing ratio ("TDSR"), we request clarification as to whether the MFDA is now imposing the obligation on Members to assess both "net worth" and "liquid net worth". Again, we felt this was clarified in our meeting and that Members will be permitted to use either method. We request confirmation of our understanding from the meeting.

## **6. Leverage Suitability – Lending Documents**

Section 4(B) of MR-0069 requires that “Where the Member or AP has made a specific recommendation to borrow money for the purpose of investing; lending documents should be maintained in the client’s file. In the event that a Member or AP only becomes aware of a client’s use of leverage after the investment loan has been made, details of the loan should be requested or suitable inquiries be made, so that the client information maintained on file is as complete as possible.”

This appears to be inconsistent with the proposals for Policy 2, Section III which state that “Whenever the Member or registered salesperson recommends or becomes aware that a client is using a leverage strategy, the Member or registered salesperson must either maintain copies of the lending documents or make sufficient inquiries to obtain details of the loan” and goes on to state that “Where the Member or registered salesperson assists the client in completing the loan application, the Member must maintain copies of lending documents in the file, including copies of the loan application.”

We submit that the proposals in Policy 2 are more practical given Members’ inability to obtain documents from the lending institutions for confidentiality and privacy reasons. We therefore submit that MR-0069 requires revision in order to harmonize the requirements to be consistent with those in Policy 2.

## **7. Trading Trend Reviews**

Section VI of the Policy 2 proposals requires that Members review all “accounts where there are more than 5 trades per month” and “accounts generating commissions greater than \$1,500 within the month.” These requirements are also prescribed in Section 3(G)(c) of MR-0069. We submit that “5 trades” and “\$1,500 in commissions” within a given month are low thresholds for trend analysis and will result in an unnecessarily high number of exceptions to be reviewed. Trades for \$37,500, which would generate commissions of \$1,500 (at 4%), are fairly common. Further, accounts with 5 trades in a month are not outside the realm of normal trading patterns. In particular, during RRSP season when clients make use of unused RRSP contributions and high volumes in activity are prevalent, these thresholds will generate high volumes of exceptions which will over burden Members. We are not aware of the resources employed by the MFDA in order to establish these thresholds. However, we recommend that the ACCP’s membership represents the broad dealer constituency and can provide insight with respect to thresholds and trading norms. We would suggest that Members be permitted to establish their own thresholds based on their specific Dealer model. However, if the MFDA is to prescribe thresholds, we suggest that these thresholds be increased to “\$2,500 in commissions” and “5 purchases” in a given month.

## Conclusion

We request that the MFDA consider the systems development and operational challenges associated with these proposals and the necessity for the provision of sufficient transition periods for Members. We commend the MFDA for seeking industry's recommendations in this regard and we respectfully submit that the ACCP's recommendations are reasonable.

Thank you for meeting with the ACCP on these proposals in advance of our submission of comments. We submit that the proposed Rules and Policies will be improved by adopting the recommendations presented.

If you have any questions regarding this submission, please contact me directly by phone or email per my contact information below.

Yours truly,

A handwritten signature in black ink that reads "Kim Maggiacomo". The signature is written in a cursive, flowing style.

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