



July 24, 2006

## **MFDA POLICY NO. 5**

### **BRANCH REVIEW REQUIREMENTS**

#### **Introduction**

This Policy establishes minimum standards for the development and implementation of branch and sub-branch review procedures. All references to “branch” in this Policy include sub-branches as defined in MFDA By-law No.1.

Members are responsible for establishing, implementing and maintaining policies and procedures to ensure that business is conducted and managed in accordance with MFDA By-laws, Rules and Policies and with applicable securities legislation. Under MFDA Policy 2, the Member is required to conduct an on-going review of sales compliance procedures and practices at both head office and at branch offices to confirm that these procedures are adequately fulfilling the purposes for which they have been designed. The requirement to complete regular branch reviews is consistent with these obligations and will serve to enhance the Member’s ability to meet the fundamental supervision requirements under MFDA By-laws, Rules and Policies.

The intent of this Policy is to establish minimum standards for internal branch review programs (“Branch Review Program”), while allowing Members sufficient flexibility to develop procedures that are appropriate to the Member’s size and business model. Accordingly, strict adherence to the minimum standards as set out in this Policy will not necessarily ensure that a Member’s Branch Review Program is effective to ensure proper supervision and compliance with MFDA Rules. The objective is for Members to create and effectively implement processes that maximize their ability to detect potential compliance issues, so that corrective action may be taken before serious problems occur. MFDA staff will assess the effectiveness of the Member’s Branch Review Program in the course of conducting compliance examinations and may impose additional requirements to ensure compliance with MFDA By-laws, Rules and Policies.

#### **Branch Review Procedures**

Each Member must establish a Branch Review Program to effectively assess and monitor compliance with regulatory requirements at all branch locations.

##### ***a) General Requirements***

- The Branch Review Program must include an assessment of the supervisory procedures and practices in place at the branch, as well as the quality of execution of those procedures.

- The Branch Review Program must address all significant aspects of the Member's policies and procedures manual and MFDA By-laws, Rules and Policies.
- The Branch Review Program must include interviews with branch supervisors and a selection of other Approved Persons along with substantive testing to verify the accuracy of information that is provided in the interviews. Substantive testing should involve reviewing client files, trade blotters, trust account records, advertising and marketing material and other relevant records.

***b) Branch Interviews***

- The purpose of the interviews is to confirm that the branch manager and Approved Persons are aware of requirements under MFDA By-laws, Rules and Policies and applicable securities regulation. It is particularly important that the reviewer confirm that the branch manager has a good understanding of the fundamental supervisory requirements. The interview process also serves as a forum for the branch manager and Approved Persons to raise and discuss issues and areas of regulatory concern.
- The interviews must also include discussion about branch policies and procedures relating to:
  - products and services offered to clients;
  - complaints;
  - advertising and sales communications;
  - referral arrangements;
  - outside business activities;
  - account opening procedures; and
  - other branch and sub-branch supervision issues.

***c) Review of Trade Blotters and Other Supervisory Review Documentation***

- Documentation must be reviewed to confirm that trade reviews have been performed adequately and in a timely manner covering the minimum requirements of MFDA Policy 2. This includes a review to confirm that all trades in exempt securities and a sample of initial trades, leveraged transactions, trades made under a limited trading authorization or power of attorney, and trades in speculative funds have been reviewed. Samples of different types of transactions, including purchases, switches and redemptions must be reviewed. Trade blotters must be reviewed to assess:
  - trading patterns;
  - evidence of supervision; and
  - timeliness of review.
- The suitability of individual trades must be assessed to confirm that the quality of trade supervision is consistent with the Member's standards and regulatory expectations.
- Trade supervision records must also be reviewed to confirm the recording of issues noted by supervisory staff, inquiries made, responses received and resolutions achieved.

***d) Review of Client Files***

- Client files must be examined to verify that there is proper account opening documentation on file and that branch client files are appropriately safeguarded. Know-your-client information must be reviewed to:
  - assess completeness;
  - confirm that back up for any changes has been maintained on file; and
  - confirm that KYC information on the back office system matches with that recorded in the files.
- The branch review process must confirm that account opening approval procedures have been properly followed, where these are the responsibility of branch staff.
- Client files must be examined to verify that proper evidence of client instructions and any relevant trading authorizations have been maintained on file. Files should be reviewed to assess the adequacy of notes regarding advice or recommendations provided to the client, as well as notes regarding discussions relating to fees and services, if any.
- Trade orders must be reviewed to:
  - assess suitability;
  - detect unlicensed / out-of-province trading;
  - confirm proper identification of leveraged trades; and
  - confirm timeliness of trade processing.

***e) Review of Sales Communications, Advertising and Client Communications***

- The Branch Review Program must include a review of sales communications, advertising and client communications, including business cards, letterhead and websites to confirm that any required approvals have been obtained.
- The branch review process must also involve, where appropriate, discussions and testing to detect:
  - misleading communications;
  - trade names of Approved Persons that have not been approved by the Member;
  - undisclosed outside business activities or personal financial dealings with clients;
  - securities related business conducted outside of the Member; and
  - undisclosed referral arrangements.
- Where the reviewer detects a potential material deficiency with respect to the conduct of outside business or personal financial dealings under MFDA By-laws, Rules or Policies, the Branch Review Program must provide for the review of files of Approved Persons relating to non-Member business.

***f) Complaints***

- The branch review process must confirm that any complaints that may have been made involving individuals at the branch have been recorded and handled in accordance with Member procedures and MFDA By-laws, Rules and Policies.

- The nature of any complaints, as well as the timeliness and fairness of resolution must be assessed.
- The branch review process must confirm that all complaints and pending legal actions are made known to the compliance officer at head office (or another person at head office designated to receive such information) within two business days in accordance with MFDA Policy No.3. (“Handling Client Complaints”).

## Scope of Review

Sample size and the extent of the review are matters of discretion for the Member. However, at a minimum, the review should involve a preliminary screening of the branch that is sufficient to provide a reasonable indication of items or issues for further investigation. Sample size and the extent of review must be reasonable based on a number of factors such as:

- the specific activities at the branch;
- complaint history;
- number of Approved Persons at the branch;
- trade volume/commissions earned;
- results of previous reviews;
- MFDA compliance examination findings;
- daily trade supervision issues;
- experience of supervisory staff at the branch;
- supervisory tools used at the branch (manual or automated);
- the nature of dual occupations or outside business activities carried on at the branch;
- the volume of leveraged trades; and
- the date of the last review.

## Branch Review Cycle and Schedule

The Member must be able to justify its branch review schedule and cycle by developing a risk-based methodology to rank branch locations as high, medium or low risk using appropriate criteria. Such criteria would include the factors set out above under “Scope of Review”. Members are generally expected to perform an on-site review of their branches no less than once every three years. However, Members must review certain branches more frequently than once every three years if justified based on risk. Where, under unusual circumstances, a Member exceeds a three year branch review cycle, the Member must be able to justify the longer review cycle by demonstrating that the branches that have not been subject to an on-site review are low risk and have been subject to alternative compliance review procedures performed by head office, such as an off-site desk review. Under no circumstances however, should a Member never perform an on-site review of a branch.

The branch review cycle and the status of completion of the branch review cycle against benchmarks should be included as part of the annual compliance report to the board of directors or partners of the Member required by MFDA Rule 2.5.2(b).

## Qualifications for Reviewers

The individuals responsible for performing the branch reviews must have the training, skills and proficiency necessary to accomplish the objectives of the review program. The individuals must possess sufficient knowledge not only to be able to follow prescribed procedures, but to be able to know where follow up review should be pursued. In addition, Members should ensure that individuals delegated the responsibility to perform branch reviews have adequate existing time or whether workloads can be rescheduled in order to provide the time necessary for proper performance.

Individuals that have successfully completed the courses required for designation as a branch manager as set out under MFDA Rule 1.2.2(a) or that have equivalent experience, training or education would generally be considered sufficiently qualified to perform branch reviews. The Member must consider the responsibilities and functions that are performed as part of a branch review and make the determination of what constitutes equivalent experience, training or education sufficient to qualify an individual as a branch reviewer. The Member will be required to satisfy the MFDA that the equivalency standard has been met.

Equivalent experience, training or education may include: audit experience, legal training in the area of securities or mutual fund regulation, or experience in a regulatory supervisory or compliance role. Members may also have an internal training program for branch reviewers, which may satisfy the equivalency test.

The branch reviewer must be independent of the branch and the branch manager, so as to ensure that the reviewer can act objectively without preconceived opinions and is not subject to inappropriate influence when performing the review.

## Reporting of Results

All serious issues detected in the branch reviews must be made known to the compliance officer at head office (or another person at head office designated to receive such information) within a reasonable period of time.

Each Member must also ensure that branch managers are made aware of all issues that are identified in the branch review in a timely manner. In addition, Approved Persons at the branch should be made aware of issues identified in the report relevant to them.

The report to the branch manager on the results of the branch review must include the following information:

- the date of the review;
- basic branch information, including the Approved Persons and staff at the branch location;
- details of any compliance deficiencies noted in completing the branch review including missing documentation or any gaps in supervision;

- the date of the report; and
- the date by which a response is required.

## Follow Up of Branch Review Findings

The Member must have procedures in place to ensure that the issues identified in the course of the branch review are followed up and resolved. Therefore, the Branch Review Program must provide for:

- consistent and timely reporting of results;
- a means of tracking responses to the reports; and
- a means of ensuring that the branch implements all required changes in a reasonable amount of time.

## Branch Review Files

Members must maintain orderly, up-to-date files for each branch that has been reviewed. The files must include details of the procedures performed at the branch and all working papers to support the work done and provide evidence of any deficiencies noted. All follow-up documentation, including the report to the branch manager, must also be included in the file. Records must be maintained for a period of seven years and must be made available for review by the MFDA, if requested.

Branch review records should be used to identify significant deficiencies that may disclose a need for further education and training of branch supervisors, Approved Persons, or other staff. When systemic issues are detected through the branch review process, a review of internal procedures and practices may be warranted.