

## **Summary of Public Comments Respecting Proposed Amendments to MFDA Rule 2.2 (Client Accounts) and MFDA Policy No. 2 *Minimum Standards for Account Supervision***

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On June 13, 2008, the British Columbia Securities Commission published proposed amendments to MFDA Rule 2.2 (Client Accounts) and MFDA Policy No. 2 *Minimum Standards for Account Supervision* (the “**Proposed Amendments**”) for a 90-day public comment period that expired on September 11, 2008.

16 submissions were received during the public comment period:

1. Advocis
2. Assante Wealth Management (“Assante”)
3. Association of Canadian Compliance Professionals (“ACCP”)
4. BMO Investments Inc. (“BMO”)
5. Borden Ladner Gervais LLP (“BLG”)
6. Canfin Magellan Investments Inc. (“Canfin”)
7. Federation of Mutual Fund Dealers (“Federation”)
8. IGM Financial Inc. (“IGM”)
9. Independent Financial Brokers of Canada (“IFB”)
10. Independent Planning Group (“IPG”)
11. The Investment Funds Institute of Canada (“IFIC”)
12. The Investment Industry Association of Canada (“IIAC”)
13. Primerica Financial Services (Canada) Ltd. (“PFSL”)
14. Royal Mutual Funds Inc. and Phillips, Hager & North Investments Funds Ltd. (“RMFI”)
15. Scotia Securities Inc. (“SSI”)
16. Worldsource Financial Management Inc. (“Worldsource”)

Copies of comment submissions may be viewed on the MFDA’s website at: [www.mfda.ca](http://www.mfda.ca).

The following is a summary of the comments received, together with the MFDA’s responses.

### **General Comments**

#### **1. Need for a Principles-Based Approach/Outcomes-Based Approach**

A number of commenters expressed the view that the amendments should be less prescriptive and more principles-based which would allow Members the flexibility to comply and manage risk in a manner appropriate for their individual business models and operating systems.

Advocis expressed support for the fact that the Proposed Amendments to Rule 2.2 have been drafted with attention to achieving outcomes. Advocis also expressed support for

the principles-based requirements with respect to relationship disclosure under proposed Rule 2.2.5.

## **MFDA Response**

*MFDA staff acknowledges that certain regulatory requirements were more principles-based prior to the development of the Proposed Amendments. Where MFDA staff has prescribed requirements in greater detail, for example with respect to the trade review thresholds proposed in Policy No. 2, this has been in response to issues identified through MFDA compliance and enforcement activity. Inadequate trade supervision and product due diligence are two of the most common deficiencies identified during compliance examinations of Members. Suitability is the most common subject matter of complaints received by the MFDA. The MFDA's regulatory experience to date has demonstrated that the current principles-based approach has not been effective in addressing these ongoing concerns. The Proposed Amendments are also intended to respond to requests from Members for more direction and establish transparent and objective minimum standards for the industry and a consistent level of investor protection. The Proposed Amendments seek to adopt a principles-based approach where this is appropriate, for example, as noted by the commenter, proposed Rule 2.2.5 sets out requirements for disclosure that are principles-based. In addition, even where the Proposed Amendments introduce prescriptive requirements, such as in Policy No. 2, MFDA staff remains open to considering alternate approaches to meeting such requirements where it can be demonstrated that such approaches meet the minimum standards set out in the Policy.*

## **2. Need for a Cost/Benefit Analysis**

IFIC and SSI expressed the view that an MFDA cost-benefit analysis is required to assess the increased operational workload and the additional costs of compliance due to the amendments.

Advocis commented that greater detail is required to justify undertaking amendments to Policies and Rules. Advocis submitted that a cost-benefit analysis is critical in determining if the benefits to be derived from the proposed regulatory intervention outweigh its costs and therefore such analysis should have been performed.

The Federation expressed concern that Members will be required to implement additional compliance procedures as a consequence of the Proposed Amendments, which will not result in improved supervision as Members will be focused on satisfying Rule requirements rather than implementing a sound compliance regime, with no identifiable benefit to the consumer, the industry or the regulatory process.

## **MFDA Response**

*As noted above, the regulatory concerns identified by the MFDA's compliance and enforcement activities, as well as the number of complaints received by the MFDA in relation to suitability concerns, have indicated that clarification for Members in this area*

*should be a regulatory priority for the MFDA. Investment suitability has also been identified as a regulatory priority by the Canadian Securities Administrators (“CSA”) who have recently undertaken their own policy initiatives in this area. Further, based on the information received from compliance examinations to date, more than 80% of Members have policies and procedures that are in compliance with either the proposed branch review thresholds or the proposed head office review thresholds. MFDA staff does not believe the Proposed Amendments go beyond the measures necessary to ensure that the regulatory concerns identified have been addressed.*

*MFDA staff has developed the Proposed Amendments over the past three years based on numerous consultations with the industry through Member Regulation Forums, the MFDA Policy Advisory Committee and other ad hoc industry meetings and practical, first-hand experience gained by MFDA staff during the course of their compliance and enforcement activities. MFDA Members were also consulted by way of industry subcommittees which were established in 2006 and presented with the original draft of the amendments for comment. In the course of these consultations, many suggestions were brought forward and discussed. Alternative viewpoints and suggestions from Members, regulators and other industry participants were also discussed at length in these consultations and input received was factored into the Proposed Amendments. Issues of cost to implement the Proposed Amendments were discussed during industry consultations. MFDA staff believes that the Proposed Amendments strike an appropriate balance between managing costs considerations and appropriately addressing the regulatory issues identified by the MFDA.*

### **3. System Changes Required**

Assante commented that there are many systems changes that Members will be required to make in order to comply with the new requirements. It indicated that there may be difficulty in creating a compliance system to accommodate these requirements and that this may not have been taken into consideration when the proposals were drafted.

#### **MFDA Response**

*MFDA staff is aware that systems changes may be required to implement the Proposed Amendments. This issue will be addressed through the provision of appropriate transition periods and MFDA staff has canvassed Members with respect to their views as to adequate transition timelines.*

### **4. Harmonization with Other Regulators**

A number of commenters noted differences between the MFDA’s Proposed Amendments and those of the Investment Industry Regulatory Organization of Canada (“IIROC”) and other regulators, in particular proposals under National Instrument 31-103 *Registration Requirements* (“NI 31-103”) and the requirements of the Point of Sale initiative of the Joint Forum of Financial Market Regulators. These commenters stressed the importance

of harmonization to avoid inconsistency, duplication and overlap for the industry and also to ensure that investors are subject to similar standards of disclosure and protection.

## **MFDA Response**

*MFDA staff acknowledges the industry concerns with respect to the need for harmonization. MFDA staff, in reviewing its proposal, has considered the IIROC Client Relationship Model (“CRM”) proposal and met with IIROC staff on a number of occasions to engage in a detailed review of both self-regulatory organizations’ (“SRO”) proposals with a view to minimizing differences and ensuring that they achieve the same regulatory objectives. As discussed in the Notice published with the Proposed Amendments, there are certain areas in which the MFDA and IIROC have adopted different approaches to achieve the objectives under CRM. Some of these result from differences in the business of MFDA and IIROC Members or the different ways in which our existing Rules are structured. MFDA staff has also engaged in discussions with CSA staff with a view to ensuring that requirements under proposed NI 31-103 are consistent with those proposed under SRO Rules.*

## **5. Input from Approved Persons and Consumers Required**

The IFB commented that there is no indication that the MFDA sought input from advisors in developing the Proposed Amendments. It also suggested that the MFDA consider the results from an investor survey recently issued by the Joint Standing Committee on Retail Investor Issues which asked investors what information they want and need when making an investment decision and how investment products should be regulated.

Advocis expressed concern that there is inadequate early participation in the policy process by non-Members.

## **MFDA Response**

*The current process in which MFDA Rule proposals are published for a period of public comment is intended to solicit and encourage participation in the policy process by non-Members. In order to facilitate meaningful input, it is necessary to draft a proposal as a starting point for discussion. All comments received during the public comment process are reviewed and considered by MFDA staff and, to the extent that such comments result in material changes, the draft proposals are published for another period of public comment.*

## **6. Carrying Dealers**

IGM recommended that the amendments specifically state that the requirements only apply to introducing dealers and not to carrying dealer except: (i) in the case of a Level 1 introducing dealer, or (ii) where the carrying dealer has agreed to perform specific

compliance functions and then only with respect to the compliance functions the carrying dealer has agreed to perform.

## **MFDA Response**

*MFDA Rule 1.1.6 currently provides that the introducing dealer shall be responsible for compliance with MFDA Rules for each account introduced to the carrying dealer subject to the carrying dealer being also responsible for functions it agrees to perform under the introducing/carrying dealer arrangement.*

## **7. Coordination of Timing with Member Regulation Notice MR-0069 – Suitability Guidelines**

Advocis questioned whether Member Regulation Notice MR-0069 – *Suitability Guidelines* (“MR-0069”), which is consistent with Proposed Amendments to Policy No. 2, needs to be replaced by Policy No. 2 at this time. Advocis submitted that there should be sufficient time allowed to first determine if the Notice achieves the MFDA’s desired outcome before resorting to another regulatory tool. Advocis expressed the view that, from a regulatory development perspective, the MFDA will not be able to determine if a change in Member and/or Approved Person actions are the result of the Notice or the Proposed Amendments.

## **MFDA Response**

*Policy No. 2 is not intended to replace MR-0069. As noted in the introduction to MR-0069, the information in the Notice reflects both existing regulatory obligations and guidelines in certain areas some of which have resulted in the proposed Policy and Rule amendments. The Proposed Amendments are inconsistent in certain respects (e.g. trade review thresholds) with the guidelines set out in MR-0069. When the Proposed Amendments are approved, MR-0069 will be updated accordingly.*

## **Specific Comments**

### **I. Rule 2.2 (Client Accounts)**

#### **A. Rule 2.2.1 (Know-Your-Client and Suitability)**

##### **1. General Comments**

IIAC noted that the Proposed Amendments requiring that the suitability of investments in a client’s account be assessed when certain trigger events occur would have a significant impact on Member firms. In particular, in order to ensure that a suitability review is conducted when one of the trigger events occurs, Members would need to have systems designed to monitor the triggers and ensure the suitability review did in fact occur and was documented in some fashion. IIAC recommended that an ongoing suitability

requirement be implemented as a best practice recommendation rather than a strict regulatory requirement.

PFSL commented that the Proposed Amendments will create a significant increase in the frequency of suitability assessments as well as the information that is to be collected for these assessments and go beyond what is required to ensure suitability. PFSL urged the MFDA to verify that the information required to be collected is pertinent to a suitability assessment and to ensure that these requirements do not duplicate other existing obligations. PFSL also noted that suitability assessments should only be performed at relevant opportunities, such as following a material change, at the time of a transaction or any other instance in which concern regarding the suitability of an account could arise.

PFSL added that a significant increase in the number of suitability assessments along with other new regulatory requirements could result in more firms establishing minimum account sizes in order to maintain the viability of their services and that the costs of such measures could impact the access of more moderate investors to affordable financial services and products.

Advocis commented that prescribing the events triggering a suitability review in the Rule is ineffective, as there could be other potential situations not contained in the Rule, which may reasonably be viewed as triggers. Advocis recommended adopting a principles-based approach in the Rule and describing the details as to types of events triggering a review in a Notice.

## **MFDA Response**

*Proposed Rule 2.2.1(e) requires overall account reviews at critical times when such assessments will be most meaningful. The review requirement is linked to events where an assessment is relevant in the circumstances. It is currently industry best practice to perform suitability assessments on certain key trigger events. Further, MFDA staff has historically interpreted Rules of general application that require fair and honest dealings with clients to include a suitability obligation. The amendments to Rule 2.2.1 are intended to codify and clarify this expectation. Members are not precluded from assessing the suitability of investments in client accounts at other times (in addition to the trigger events set out in Rule 2.2.1) as a best practice.*

*It is acknowledged that systems changes will be required to comply with the Proposed Amendments. Accordingly, the MFDA will be considering appropriate transition periods for the implementation of the requirements to ensure that Members are provided with sufficient time to comply.*

## **2. Removal of “from Time to Time” (Rule 2.2.1(a))**

IFIC, SSI, Canfin, BMO and IGM recommended the removal of “from time to time” from Rule 2.2.1(a). It was suggested that arbitrary changes to the essential facts may require modification of forms, back-office systems, salesperson behaviour and

unnecessary and expensive re-collection of client information. IGM commented that any modifications made to these requirements should go through the public comment process.

BMO recommended that Members be given flexibility to look at their own core client base to determine what KYC information they will collect, rather than having these matters prescribed by the MFDA. BMO noted that if the MFDA were to prescribe the minimum information to be collected, Members would be forced to collect information that may not be relevant to the majority of their clients. BMO expressed the view that the wording of Rule 2.2.1(a) should remain in its current form, as it gives Members enough principled guidance while taking into consideration their own business models.

### **MFDA Response**

*The reference to “as may be prescribed by the Corporation from time to time” has been removed from Rule 2.2.1(a). The minimum information that must be collected on account opening is set out in Policy No. 2. Any amendments to these requirements would be subject to the SRO Rule review and approval process that would involve approval by the Board of Directors, CSA review and approval and the publication of any proposed amendments for public comment.*

*The requirements set out in Policy No. 2 represent the minimum information necessary to operate the account and know the client. While there may be specific situations where it is possible to assess suitability without certain information, it would be difficult from a compliance monitoring perspective to carve out exceptions on an account basis. For example, a client may purchase a simple Guaranteed Investment Certificate (“GIC”) when they open an account, making it seem unnecessary, at the time, to collect detailed information with respect to net worth, but later decide to purchase a higher risk mutual fund. If the information is not collected on account opening, it may be difficult to obtain it later.*

### **3. Essential Facts (Rule 2.2.1)**

RMFI commented that the requirement for each Member and Approved Person to use due diligence to ensure that each order accepted or recommendation made for any account of a client is suitable for the client based on “essential facts relative to the client” is unduly broad. RMFI suggested that the requirement should refer to “KYC” information, which is the commonly used term as understood by Members and also referred to in MFDA Policy No. 2.

### **MFDA Response**

*The requirement for the Member and Approved Person to use due diligence to “learn the essential facts” is a general statement of the principles-based obligation to collect the facts necessary to know the client and assess suitability. Such facts will include, but may not necessarily be limited to, the enumerated items set out in Policy No. 2. Depending on the circumstances, the Member or Approved Person may need to collect other information to fully understand the client’s investment needs and objectives.*

#### **4. Suitability Assessment Triggers (Rule 2.2.1(e))**

##### **(a) *Timeline for Review – Assets Transferred in/Change in Approved Person***

IFIC, Canfin, SSI and Worldsource expressed the view that, where there is a transfer of assets into an account at the Member or a change in the Approved Person responsible for the client's account, there should be adequate time for the review to occur. IFIC and SSI suggested that the review should be required prior to the first transaction in the account following the change, with allowance for automated transactions to continue.

##### **MFDA Response**

*Policy No. 2 requires the Approved Person to assess the suitability of investments in each client account within a reasonable time, but in any event no later than the time of the next trade. The determination of reasonable time in a particular instance will depend on the circumstances surrounding the event giving rise to the requirement to perform the suitability assessment. For example, with respect to client transfers, the volume of accounts to be reviewed may be a relevant factor in determining reasonable time. Where an Approved Person is transferring a large book of business to the Member, it may be reasonable to ensure that the suitability assessments are done within a year if there are no trades on the accounts. If; however, one client transfers assets into an account at the Member from another dealer or financial institution, it is reasonable to expect that the suitability assessment would be done relatively quickly. If the timeline for review was based solely on the timing of the first trade on the account after the transfer, there would be no change to the frequency of suitability assessments required currently under MFDA Rules.*

*With respect to the suggestion that an allowance be made for automated transactions to continue without a suitability assessment being made, there is no exception from suitability obligations under current MFDA Rules or securities legislation with respect to trades made under automatic payment plans.*

##### **(b) *Member Review – Assets Transferred in***

BMO requested clarification with respect to the suitability review trigger in Rule 2.2.1(e)(i). As the preamble to Rule 2.2.1 states that "Each Member and Approved Person shall use due diligence", subsection (e)(i) suggests that the Member itself is required to do something over and above the Approved Person's suitability review at the time the transfer-in instruction is made. BMO indicated that it does not believe that the MFDA intended for the Member to perform a suitability review separate and apart from the Approved Person's review for every transfer-in and suggested that this could be clarified by inserting the words "*by the Approved Person*" at the beginning of subsection (e)(i), similar to subsection (e)(iii).

## **MFDA Response**

*Approved Persons are required to review the suitability of investments in the client's account whenever the client transfers assets into an account at the Member. Policy No. 2; however, also requires that Members, on a sample basis, review the suitability of investments in accounts where clients have transferred assets into an account. Accordingly, the wording of Rule 2.2.1(e)(i) has not been amended.*

### **(c) Material Change Trigger for Suitability Review**

BMO urged the MFDA to reconsider the wording of Rule 2.2.1(e)(ii). Given the definition of “material change in client information”, which is defined as information that could reasonably result in changes to the stated risk tolerance, time horizon, or investment objectives of the client or that would have a significant impact on the net worth or income of the client, BMO noted that a material change in client information cannot itself trigger a suitability review. BMO expressed the view that the material change in client information must result in an *actual* change to risk tolerance, time horizon or investment objectives before a suitability review can be triggered. BMO recommended that the material change only trigger a re-evaluation and update of the client's risk tolerance, time horizon or investment objectives.

## **MFDA Response**

*MFDA staff acknowledges the concerns expressed by the commenter and has amended the definition of “material change in client information” to remove the reference to “could reasonably result”. The amended definition reads as follows:*

*“material change in client information” means any information that results in changes to the stated risk tolerance, time horizon or investment objectives of the client or would have a significant impact on the net worth or income of the client.”*

### **(d) Meaning of “Transfer” of Assets by a Client**

RMFI suggested that the MFDA clarify what constitutes the “transfer” of assets by a client in Rule 2.2.1(e)(i). Specifically, RMFI questioned if a “transfer” includes a deposit or if a “transfer” only involves the movement of assets from an account at one dealer to an account at another dealer.

## **MFDA Response**

*Transfer of assets would include the deposit of assets by a client into an account at the dealer as well as the transfer of assets from an account at one dealer to an account at another dealer. The Approved Person must perform a suitability assessment in all cases where clients have transferred assets into an account at the dealer and the Member's head office must also perform a suitability review on a sample basis focusing on the risk level of the account in accordance with the factors set out in Policy No. 2.*

**(e) Suitability Assessment where Change in Approved Person**

IFIC, Canfin, PFSL, IGM and Worldsource expressed the view that the requirement under Rule 2.2.1(e)(iii) for a formal, documented suitability review where there has been a change in the Approved Person is unnecessary and should be removed. It was submitted that, in these cases, to the best of the dealer's knowledge, nothing has changed that might render the investments unsuitable and a provision requiring a new representative to familiarize him/herself with the file already exists in the Rules and is manageable. PFSL noted that this requirement will increase the advisor's workload, while adding costs and inconvenience that will ultimately be borne by clients.

SSI, noting that it does not assign accounts to individual Approved Persons, recommended that the words "*if applicable*" be added to Rule 2.2.1(e)(iii).

**MFDA Response**

*Under current Policy No. 2, Approved Persons are already required to review the client's KYC information where they have been assigned responsibility for a client's account. At the same time, they should also be reviewing the investments in the client's account to assess suitability. Rule 2.2.1(e)(iii) is intended to formalize and codify an existing practice by requiring that Approved Persons document their review. If accounts are not assigned to individual Approved Persons, the requirement in Rule 2.2.1(e)(iii) does not apply.*

**5. Advising Clients of Unsuitable Investments (Rule 2.2.1(f))**

BLG commented that the due diligence obligations in assessing the suitability of each investment in the client's account, as proposed by Rule 2.2.1(e), could prove onerous or effectively impossible to meet in the case of certain prospectus-exempt and/or registration-exempt securities. BLG noted that if a Member and Approved Person are unable to assess the suitability of a transferred investment in order to comply with section 2.2.1(e), they will be unable to comply with section 2.2.1(f) as drafted. BLG submitted that Members and Approved Persons should be exempt from sections (e) and (f) of Rule 2.2.1 for transferred investments provided that written notice is promptly sent to the client advising which of the transferred investments are not subject to a suitability assessment. In the alternative, Members and Approved Persons should be specifically permitted, after performing and recording a reasonable level of due diligence, to classify transferred investments as "high risk" or "speculative" for purposes of assessing suitability where the information that is needed to assess suitability is not readily available.

BMO expressed the view that the reference in Rule 2.2.1(f) to "*...where investments in a client's account are determined to be unsuitable...*" appears to suggest that Members have an ongoing obligation to review suitability of a client's investments even without a trigger having taken place.

## **MFDA Response**

*It is recognized that it may be difficult in some circumstances for Members to assess a product transferred into a client's account if they have never sold it. If Members have concerns with respect to a product that a client is holding, they have the option of advising the client that they will not accept the transferred investment. In the alternative, they may, as suggested by the commenter, classify the transferred investment as "high risk" or "speculative" for purposes of assessing suitability. If information with respect to the transferred investment is not readily available, it is likely because the investment is not liquid. Accordingly, classifying the investment as "high risk" or "speculative" would be reasonable in these circumstances.*

*Rule 2.2.1(f) applies whenever the Member or Approved Persons performs a suitability assessment. There is no ongoing obligation to assess suitability of a client's investment without a trigger having taken place. However, if the Member or Approved Person chooses to perform a suitability assessment without a trigger having taken place, section (f) still applies.*

### **B. Rule 2.2.2 (New Accounts)**

IFIC, IGM and Canfin recommended that the Rule clarify that the obligation to open an account within a reasonable time arises only when the account application is received in good order. RMFI commented that the requirement that each new account for a client be opened by the Member within a reasonable time of the client's instructions should reflect that there may be uncontrollable delays when the client has not met other regulatory requirements such as anti-money laundering and terrorist financing requirements, or if the documentation received is not otherwise in good order.

IFIC and the ACCP requested clarification as to when an account is considered open.

## **MFDA Response**

*The obligation to open an account within a reasonable time arises when the account application is received in good order. Policy No. 2 provides that New Account Application Forms ("NAAFs") must be prepared and completed for all clients prior to the opening of new client accounts. NAAF's for clients of Approved Persons transferring to the Member must be prepared and completed within a reasonable time (but in any event no later than the time of the first trade). In these cases, the account can be opened with the client's name and address on the dealer change form pending completion of the NAAF. It is recognized that there may be uncontrollable delays where the client has not met other regulatory requirements and this may be taken into account when determining reasonable time for the purpose of the Rule.*

*An account is considered open when the necessary approvals have been obtained and an account number has been assigned.*

### **C. Rule 2.2.3 (New Account Approval)**

IFIC and Canfin recommended that the original wording of Rule 2.2.3 be maintained given that, as per standard industry practice, approval of forms is completed prior to or promptly after completion of any initial transaction. IFIC recommended replacing “no later than one business day after the date that the account is opened” with “within a reasonable time (but in any event no later than the time of the first trade)”.

The ACCP commented that Members currently approve a new account along with the initial transaction, which results in a comparison of the essential facts of a client and the essential facts of the order. It submitted that account approval without 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.

BMO noted that Rule 2.2.3 and Policy No. 2 require new accounts to be approved no later than one business day after they are opened. BMO indicated that, based on the new requirements for daily trade surveillance, all initial trades will have to be reviewed, resulting in the account having to be reviewed twice – once at account opening and again at completion of an initial trade if it occurs at a later date. BMO stated that it does not believe that all initial trades need to be approved by the branch manager. BMO added that, if the MFDA’s proposed trade review thresholds are maintained, all initial trades falling within these thresholds will be reviewed and that there is no reason for initial trades to be subject to a more onerous level of scrutiny than subsequent trades. BMO also noted that if a new account is opened separately from when the client makes the initial trade (for example if the client chooses to postpone making trading instructions), there would be no way to link the trade back to the new account or identify it as the first trade on the account.

### **MFDA Response**

*MFDA staff acknowledges the concerns expressed by the commenters and has revised the Proposed Amendments to Rule 2.2.3 to clarify that new accounts must be approved no later than one business day after the initial transaction date. In light of the revised requirement with respect to the timing of new account approval, it is appropriate that the branch manager also approve the initial trade at the same time. When reviewing the NAAF, the branch manager must also consider the initial trade to ensure that it is consistent with the client’s KYC information.*

### **D. Rule 2.2.4 (Updating Client Information)**

#### **1. Scope of Material Change**

IFIC and Canfin commented that, while having material changes in KYC information such as risk tolerance examined by an Approved Person is appropriate, requiring all material changes to be approved by the designated individual under Rule 2.2.4 (c) is

unnecessary. IFIC and Canfin suggested clarification by adding “as defined in 2.2.4 (a)” following “material change in client information”.

## **MFDA Response**

*The definition of “material change in client information” in paragraph (a) of Rule 2.2.4 applies to all of the requirements in Rule 2.2.4. Accordingly, the requirement for supervisory staff approval of material changes in paragraph (c) of Rule 2.2.4 is already limited to the changes defined in paragraph (a).*

## **2. Requirements Regarding Updating Client Information Too Restrictive**

A number of commenters expressed the view that the requirements with respect to updating client information in Rule 2.2.4 are too restrictive and already subject to internal risk management controls of Members. Worldsource commented that the proposed process for updating KYC information in Rule 2.2.4 is impractical for Members that handle updates through a call center. The commenters recommended that the Rule contain only principles and allow Members flexibility to manage risk.

PFSL expressed the view that the Rule is overly prescriptive in that it establishes the use of client signatures as the only acceptable method of managing risk. PFSL noted that client signatures are not the most effective means of authenticating client instructions and, therefore, it is not appropriate to limit authentication mechanisms to client signatures.

Advocis commented that the client signature requirement for changes to client address and banking information will increase compliance responsibilities and that the broader policy concern underlying this requirement is not clear.

SSI noted that the primary obligation should be on the Member to have adequate controls in place to ensure client updates to material changes are accurately recorded and approved by the client and that the obligation to confirm any changes should, in the normal course, take place at the time of the next client interaction with the dealer. SSI added that requiring the approval of all material changes by the designated individual is unnecessary and would be inefficient for a large integrated financial services group. SSI submitted that it should be able to rely on change controls implemented by its parent, or by other wholly-owned subsidiaries, provided timely access controls are agreed to.

BMO urged the MFDA to reconsider the prescriptive nature of this section, particularly as it relates to the need for a client signature for a change in client address. BMO noted that, like other dealers that are members of large financial groups, it is able to leverage off the robust and sophisticated technological tools of the financial group and, as a result, does not collect client signatures to initiate address changes but rather uses an enterprise-wide database that allows for the performance of profile maintenance activities (such as address updates) at the enterprise level. BMO proposed that, in cases where a Member is able to utilize a technological process that minimizes paper, uses electronic “documentation” and strikes an appropriate balance between preventative and detective

controls, including a reliable audit trail, the MFDA should be open to considering it as a suitable alternative to collecting a client signature.

## **MFDA Response**

*Through compliance and enforcement activity, MFDA staff has identified situations where unverified changes in client address and banking information have facilitated fraud and misdirection and misappropriation of mail, including redemption cheques. The requirement to properly verify client address changes is necessary in light of the risk of fraud and misappropriation. Rule 2.2.4(d) has been amended to include other internal controls that are sufficient to authenticate the client's identity and verify the client's authorization. The client signature requirement, however, is not limited to physical, hard copy signatures but also includes electronic signatures such as telephonic recordings or the use of a password protected web access system. As further discussed in MFDA Member Regulation Notice MR-0016 – Electronic Signatures, an electronic signature does not have to look like a physical signature in order to be valid and binding. For example, the signature can be a code, sound or symbol of any kind and could be part of or separate from the document it signs as long as the association with the document is clear.*

### **3. Update to KYC Information Triggered by Client Instructions Only**

BLG noted that paragraph (c) of Rule 2.2.4, which provides that all changes to KYC information are to be based on client instructions alone and that the Member must maintain evidence of such instructions, is inconsistent with the wording in paragraphs (a) and (b). BLG noted that the definition of “material change in client information” in Rule 2.2.4(a) is not limited to information provided by the client and confirmed by client instructions as it refers to “any information that could reasonably result in changes.”

BLG commented that Rule 2.2.4(b) does not refer to client instructions and expands the obligation to update KYC information to “any material change in client information whenever a Member or Approved Person *or other employee or agent* (emphasis added) becomes aware of such change including pursuant to Rule 2.2.4(c)”. BLG expressed the view that unless such employee or agent has specific responsibility for maintaining or updating KYC information, only the Member and the client's Approved Person should have such an obligation. BLG also noted that Policy No. 2, which requires the registered salesperson or Member to update the KYC information, is inconsistent with Rule 2.2 that imposes the obligation whenever an Approved Person, Member, an employee or agent becomes aware of a material change.

IGM expressed the view that the obligation to update KYC information should be triggered only where the client advises the Member or Approved Person of the change and that KYC information should not be updated without client acknowledgement.

BLG also suggested that the responsibility of the client to inform the Member and Approved Person of material changes should be provided for in Rule 2.2.5(e). The IFB

was also of the view that there should be some recognition of client responsibility in communicating material changes to the advisor or firm.

## **MFDA Response**

*We acknowledge the comment with respect to Rule 2.2.4(c). As noted above, the definition of “material change in client information” has been revised to remove the reference to “could reasonably result”. With respect to the discrepancy between the language of Rule 2.2 and Policy No. 2, Rule 2.2.4(b) has been amended to remove the reference to “other employee or agent”. “Approved Person” in MFDA By-law No.1 has been broadly interpreted by MFDA staff to include employees or agents who conduct or participate in the dealer business of the Member. Accordingly, the obligation with respect to updating KYC information in Rule 2.2.4 applies to any relevant employee or agent, such as a compliance staff or other branch or head office staff, who has any involvement with the client’s account. Policy No. 2 has also been amended to reference “Approved Person” rather than registered salesperson to conform with the wording of Rule 2.2.4(b).*

*For the purpose of greater clarity, if a Member or Approved Person becomes aware of any information that could result in a material change to client information, the Member or Approved Person will be expected to discuss that information with the client and, where the client has confirmed the need for change, to update the client’s KYC information accordingly. The client’s KYC information must not be updated without confirmation by the client. As set out in Policy No. 2, the client’s confirmation may be evidenced by a client signature or by maintaining notes in the client’s file with details of the client’s instructions and providing the client with the opportunity to make corrections to the changes made.*

*With respect to the suggestion to amend Rule 2.2.5(e) to provide for the responsibility of clients to inform Members of material changes, we note that the MFDA cannot enforce regulatory obligations on clients. Policy No. 2 does provide that Members should advise clients on account opening to promptly notify the Member of any material changes in client information previously provided to the Member and provide examples of information that should be regularly updated. In addition, Rule 2.2.4 currently requires Members, at least annually, in writing, to request each client to notify the Member if there has been any material change in client information previously provided to the Member.*

## **E. Rule 2.2.5 (Relationship Disclosure)**

### **1. General Comments**

IIAC expressed support for the removal of requirements included in previous MFDA draft proposals that are duplicative with disclosure required under securities legislation, other MFDA Rules and other ongoing regulatory initiatives. IIAC also commended the MFDA for its more flexible approach to relationship disclosure. In particular, IIAC

noted that permitting Members to provide the relevant client disclosure in either one document or several recognizes that some Members already meet the proposed requirements. However, IIAC suggested that an industry-wide relationship disclosure document would eliminate the need for separate relationship disclosure documents or a combined document for different accounts and proposed an alternative model.

The IFB expressed the view that the content and procedures related to relationship disclosure and KYC do not recognize the different levels of service a client can choose to have with an advisor and a firm. The IFB suggested that a client who wishes to invest a nominal amount in a mutual fund to make a one-time contribution to a RRSP will likely find the level of detail prescribed unnecessary and objectionable. The IFB commented that clients should not be forced to divulge detailed personal financial information when they find it to be inappropriate and that there should be an opt-out provision that would clearly state that more detailed information is not being collected at the client's direction. The IFB expressed support for a principles-based approach to disclosure whereby various categories of disclosure are set out with discretion to choose information relevant to the particular client or client's account.

### **MFDA Response**

*With respect to the comment that clients should be permitted to opt out from providing detailed personal financial information when they find it inappropriate, MFDA's compliance and enforcement experience to date indicates that the information specified is the minimum required to assess suitability and operate the account. This information is essential to discharging the fundamental obligation to assess suitability and its collection is also required under provincial securities legislation.*

*With respect to suggestions that the MFDA adopt a flexible, principles-based approach, Rule 2.2.5, as proposed, already achieves this as it sets out general principles that establish a minimum standard of disclosure, which Members may choose to customize.*

## **2. Delivery on Account Opening**

Assante commented that while the provision of written relationship disclosure is beneficial to clients, where the client establishes multiple accounts over a time period (i.e. 6 months), there is no added benefit to receiving this information at each account opening. It suggested that, provided there has not been a change to the required information, an allowance be made to provide it once on an annual basis.

### **MFDA Response**

*The relationship disclosure is intended to provide clients with information about the role and responsibilities of the Member and how the account will be operated. When a new account is opened, the client should be informed as to whether the relationship that applies to the new account and the manner in which the new account will be operated are the same or different from those of accounts that the client may have with the Member.*

*This disclosure requirement applies at account opening and there is no ongoing requirement to provide such disclosure on an annual basis.*

### **3. Nature of the Advisory Relationship (Rule 2.2.5(a))**

IFIC and SSI requested clarification and explanation as to what constitutes a description of the nature of the advisory relationship.

#### **MFDA Response**

*This section contemplates a brief description of how the advisory relationship operates, which may include a statement that the client is responsible for making investment decisions but can rely on the advice given by the Approved Person and that the Approved Person is responsible for the advice and ensuring that it is suitable based on the client's investment needs and objectives. MFDA staff will be issuing a Member Regulation Notice to provide additional guidance with respect to the level of detail to be set out in the relationship disclosure document.*

### **4. Description of Products and Services Offered (Rule 2.2.5 (b))**

IFIC, SSI, IGM and Canfin commented that the requirement to disclose all products and services offered by the Member is confusing. IFIC, IGM and Canfin requested clarification that Rule 2.2.5(b) refers only to generic descriptions of products and services rather than product-specific descriptions.

#### **MFDA Response**

*The requirements of this section refer to generic descriptions (i.e. product type/class sold: mutual funds, GICs, exempt products, etc). Where Members only sell proprietary products or mutual funds of a related issuer, this should also be disclosed. MFDA staff will be issuing a Member Regulation Notice to provide additional guidance with respect to the level of detail to be set out in the relationship disclosure document.*

### **5. Suitability of Orders Accepted/Recommendations Made (Rule 2.2.5(d))**

BLG commented that the description of the Member's obligation in Rule 2.2.5(d) to ensure that each order accepted for any account must be suitable does not consider that an order that is not recommended can be accepted provided that the Approved Person cautions the client that the investment to be purchased is not suitable under Rule 2.2.1(d).

#### **MFDA Response**

*The wording of Rule 2.2.5(d) has been revised to reference the Member's obligations to assess investment suitability in accordance with Rule 2.2.1. MFDA staff will provide further guidance with respect to this issue in a Member Regulation Notice.*

## **6. Defining KYC Terms (Rule 2.2.5(e))**

IFIC and SSI recommended removing Rule 2.2.5(e). IFIC and SSI suggested that the requirement for advisors to define the various terms with respect to KYC through written disclosure simply increases the volume of materials to be provided at account opening. PFSL commented that generic and easily understandable disclosure of the importance of suitability and KYC information would be of greater value to clients.

RMFI indicated that, while it agrees that it would be beneficial to clients to define certain terms (i.e. risk tolerance categories and investment objectives), not all KYC information requires definition as such terms are, in most cases, self-explanatory (i.e. income). RMFI also suggested that firms should be permitted to have flexibility to define KYC terms in a manner that corresponds to their sales process.

### **MFDA Response**

*The requirements of this section do not contemplate defining all KYC terms, as it is acknowledged that certain terms, such as age, are self-explanatory. “Risk tolerance”, “investment objectives” and “time horizon” are examples of key KYC terms that should be defined. MFDA staff has found that Members and clients may attribute different meanings to these terms, which may prevent clients from understanding the basis on which their investments will be assessed.*

*MFDA staff agrees that Members must define KYC terms in a manner that corresponds to their sales process. The KYC terms set out and defined in Appendix 1 (Example of KYC Information) of MR-0069 are intended as examples to provide guidance to Members with respect to the type of terms to be defined and level of detail expected.*

## **7. Description of Compensation/Reference to Other Sources of Information (Rule 2.2.5(g))**

BMO expressed the view that Rule 2.2.5(g) is not clear and asked for clarification as to whether “referring the client to other sources for more specific information” means that Members must provide additional sources of information relating to the nature of compensation paid to the Member, or that the Member must provide information on how to contact the Member generally. If the latter is intended, BMO noted that this is more suited as a separate point (h) rather than being included in (g).

### **MFDA Response**

*Members may satisfy the requirements of this section by referring a client to existing sources of information, e.g. the prospectus, point of sale disclosure document or offering memorandum. In addition, clients may also be advised to speak to their Approved Person for more information about the nature of compensation paid to the Member. MFDA staff will be issuing a Member Regulation Notice to provide additional guidance with respect to the level of detail to be set out in the relationship disclosure document.*

## **II. Policy No. 2 *Minimum Standards for Account Supervision***

### **1. Deviation from Policy No. 2**

A number of commenters expressed the view that the requirement for MFDA pre-approval of all alternative policies and procedures is unnecessary and burdensome and will destroy the diversity of the channel and limit the ability to respond to new risks according to the circumstances of the firm.

Advocis commented that the MFDA pre-approval requirement should be removed given that development or amendment of all internal policies and procedures must obtain approval from senior management of the Member thus making senior management responsible for determining if their internal policies meet the requirements stated in MFDA Policy.

RMFI also suggested removing the phrase “minimum standards” from the requirement that Members seeking to have alternative policies approved must demonstrate that all of the principles, objectives and minimum standards set out in Policy No. 2 must be properly satisfied. RMFI indicated that alternative policies and procedures will likely have different minimum standards to effectively address the specific risk management issues of the Member.

### **MFDA Response**

*The new section in the Introduction to Policy No. 2, which provides that Members may adopt alternative policies and procedures that differ from those in the Policy with the pre-approval of MFDA staff, was requested by members of the MFDA Policy Advisory Committee to allow Members flexibility in complying with the minimum thresholds. For example, there are certain Members that have a suitability framework that assesses, at the time of each trade, whether the trade will result in the portfolio varying from the KYC information on file for the client. Accordingly, thresholds are not particularly relevant in this case and MFDA staff would consider this method as complying with the minimum standards of the Policy.*

*Pre-approval of alternative approaches is required in order to achieve a level-playing field among Members and to establish a consistent level of investor protection. In light of the fact that all Members have been subject to at least two examinations, providing pre-approval to Members with alternative arrangements is a fairly simple and straightforward process. Further, historically, Members who wish to change their suitability framework generally approach MFDA staff in advance as a prudent business practice to ensure that they are not incurring time and cost on a new structure that might not comply with MFDA requirements. The requirement for pre-approval of alternative policies and procedures codifies existing practice and does not impose any new requirements. Further, the pre-approval requirement would generally apply to changes to material aspects of a Member’s supervisory system such as changes to the Member’s trade review thresholds that deviate from the minimum standards set in the Policy.*

*Members are provided with flexibility in meeting the minimum standards and it is acknowledged that there may be differing approaches to achieving the same regulatory result; however, it is necessary to retain the notion of “minimum standards” in order to ensure consistency in the level of investor protection.*

## **2. Establishing and Maintaining Procedures – Delegation of Procedures**

IFIC and Canfin expressed the view that this section serves no useful purpose and should be removed as the principle of delegating tasks and procedures, but not accountability, to a knowledgeable and qualified individual is covered in section 1 of the Rule. PFSL noted that the first sentence would suffice to communicate the intention of the principle.

IPG expressed the view that it is onerous and costly to expect only branch managers to perform trade suitability review tasks. It was suggested that, while responsibility for suitability of trades ultimately belongs to the salespersons and branch managers, tasks are generally delegated to administrators. IPG also requested clarification with respect to the definition of a “task” and what tasks unlicensed administrators are permitted to perform with respect to trade suitability administration.

### **MFDA Response**

*This section was drafted in response to requests from Members for clarification with respect to what tasks can be delegated and the required proficiency to perform a delegated task. The purpose of this section is to confirm the general principle that tasks must be delegated to individuals with the same proficiency as the delegating supervisor. The section also provides flexibility where the Member can demonstrate that the individual performing the delegated task has equivalent training, education or experience related to the function being performed.*

*Through compliance reviews, MFDA staff has identified situations where individuals are performing tasks related to trade supervision without the requisite knowledge or experience. These types of tasks must be performed by individuals that possess the proficiency of a branch manager or compliance officer, although these individuals need not be registered in these categories. Branch managers, for example, are required to possess two years experience as a salesperson, which allows for a full understanding of the activities that they are supervising. MFDA staff believes that trades cannot be properly reviewed unless an individual has the type of experience and understanding that branch managers and compliance officers have of trade suitability procedures.*

## **3. Education**

IFIC, IGM, SSI and Canfin suggested that compliance-related information need not be circulated to all employees and recommended restoring the original wording specifying that information “must be communicated to registered salespersons and relevant employees”. IGM commented that sending this information to all employees would serve no useful purpose, particularly for a large dealer where many employees perform

administrative functions. Assante expressed the view that removing the word “relevant” means that many employees will receive unnecessary notices and bulletins that are unrelated to their job function and this may cause confusion and misunderstanding.

#### **MFDA Response**

*The wording of the section has been revised in response to comments received from Members through the Rule Review Survey, which suggested that the requirement to circulate information contained in compliance-related bulletins to all Approved Persons was not appropriate as not all information will be applicable to the Member’s business, nor will it be applicable to all Approved Persons. The revisions to this section qualify the information that must be circulated by adding the word “relevant”. The intention of the revised wording is to clarify that only information that is relevant to a salesperson or employee must be sent to that individual salesperson or employee. For example, financial compliance bulletins generally will only be relevant to accounting staff and senior management.*

#### **4. Documentation of Client Account Information**

##### **(a) Requirement for Approved Person to Maintain Copy of NAAF (section 2)**

SSI noted that, as it does not assign accounts to Approved Persons, the requirement for the salesperson to maintain a copy of the NAAF should be only “*if applicable*”.

#### **MFDA Response**

*We have amended the Policy to generally require that Approved Persons have access to the documentation and information as required to service the client’s account.*

##### **(b) Specifying Income and Net Worth (sections 4(k) and (l))**

SSI recommended that section 4(k) specify whether net income is being reported and that section 4(l) be amended to read “*calculation of total and liquid net worth*”.

#### **MFDA Response**

*Income may be obtained on either a net or gross basis, as long as it is specified which figure is being used. There has been confusion with respect to the meaning of liquid net worth. Further, we believe the key components are liquid assets and total net worth and have amended the Policy accordingly.*

##### **(c) Employment Information (section 3(e))**

BLG suggested that section 3(e) should specify the “employment information” to be obtained. BMO added that, with the exception of information in respect of occupation, it does not believe that information relating to all aspects of a client’s employment offers any further substantive knowledge to the Approved Person that would ensure that mutual

fund investing, or a specific transaction, is suitable for the client and in keeping with the client's investment objectives.

### **MFDA Response**

*Sufficient inquiries should be made to obtain information necessary to properly service and administer the account. For example, information that would impact on the suitability of investment recommendations, such as whether the client's employment is seasonal, part-time or full-time, should be collected.*

#### **(d) Dependants (section 3(f))**

With respect to the requirement in section 3(f) to provide the number of dependants, IFIC, SSI, BMO and Canfin requested clarification as to how this information will be beneficial in determining and assessing client suitability and recommended its removal. BMO indicated that such information would be more appropriate in a financial planning context where trust, estate and succession planning services may be provided.

### **MFDA Response**

*While this requirement does have a financial planning component, the number of dependants is also important in the determination of the amount of income available for investing.*

#### **(e) Information Required by Other Legislation (sections 3(g)(h)(o)(p))**

IFIC, SSI and Canfin recommended removal of the requirement in section 3(g) and 3(h) to obtain information regarding other persons with trading authorization on the account and other persons with a financial interest in the account. It was noted that these requirements already exist under current anti-money laundering rules and are therefore unnecessary to be included in an MFDA Rule.

IFIC, Advocis, PFSL, RMFI, Worldsource and Canfin recommended removal of the requirements to provide information required for relevant tax reporting and for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulation*, as this information is already subject to federal laws and is therefore unnecessary to be included in an MFDA Rule. PFSL also noted that the requirement to provide the nature of the business in item 4(e) was duplicative with requirements under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulation*.

### **MFDA Response**

*Through compliance reviews, MFDA staff has identified situations where Members were unaware of requirements under other relevant legislation. Accordingly, these items were included with the intention of assisting Members by providing a complete checklist of client information required on account opening.*

**(f) Net Worth (section 3(n))**

IFIC, RMFI and SSI recommended that the Rule not specify details of net worth calculations and expressed the view that clients may not be comfortable providing this information as such details are not relevant to assessing KYC. IFIC and SSI suggested changing the requirement to provide details of liquid assets, fixed assets and liabilities to only require calculation(s) of liquid and total net worth. With respect to section 3(n), PFSL suggested that “liquid net worth” would be more appropriate than a calculation of net worth in assessing the suitability of most investments.

BMO submitted that net worth should be depicted on the application form using reasonable ranges with more detailed information being collected when needed, such as at the time of a leveraged trade or the completion of a financial plan. BMO also noted that requiring detailed net worth information for even the smallest mutual fund purchase will lead to privacy concerns on the basis that the degree of specificity in the collection of the client’s personal information is disproportionate to the information required for the service they are requesting. BMO added that, typically, investors do not have detailed calculations on hand and will provide approximations in order to proceed with a transaction in a timely fashion, making the information no more valuable or accurate than if the client had selected a reasonable range.

IGM suggested that Members should only be required to obtain a breakdown of client net worth between liquid and total net worth in the event that the client is considering a leverage investment.

**MFDA Response**

*As a general matter, we note that there is significant confusion among Members as to what “liquid net worth” means. The Policy has been amended to require, at a minimum, details of liquid assets and total net worth. It is noted that ranges may be used as long as they are sufficiently narrow to be meaningful. When assessing suitability, the lowest end of the range should be used. The calculation of net worth is very important not only where leverage is used or considered but also in determining the suitability of investments generally. For example, where clients are considering risky investment strategies or investments with a long-term maturity date, it would be important to consider whether the client has sufficient liquid assets to cover their obligations and any potential risk.*

**(g) Joint Accounts**

IFIC, BMO, SSI and IGM recommended that, in the case of a joint account, risk tolerance be assessed on an account rather than individual basis, as otherwise it would be difficult to open a joint account where individual risk tolerance levels conflicted.

RMFI commented that, in joint accounts, flexibility should be provided so that KYC information could be assessed at either the investor or account level.

## **MFDA Response**

*The exclusion of risk tolerance from the list of items that must be collected on an account basis for joint accounts was a drafting oversight that has been amended accordingly.*

*With respect to joint accounts, certain KYC information such as age and investment knowledge should be collected for each individual account holder. Annual income and net worth can be collected for each individual or on a combined basis as long as it is clear which method has been used. Investment objectives, time horizon and risk tolerance; however, should relate to the account and should not be collected separately for each individual account holder.*

### **(h) Investment Knowledge – Legal Entities (section 4(g))**

With respect to the requirement to obtain information concerning the investment knowledge of the persons responsible for providing instructions on the account in section 4(g), IFIC, SSI and Canfin requested clarification as to whose investment knowledge is to be assessed (i.e. decision makers, or owners) and what is to be done in the case of conflicting investment knowledge. IFIC suggested modifying this requirement to read, “investment knowledge of the entity”.

## **MFDA Response**

*A corporation, trust or other type of legal entity itself does not have the capacity to possess knowledge or make decisions. As such, the investment knowledge of the persons responsible for making the investment decisions for the legal entity must be assessed. Other KYC information would relate to the beneficial owner.*

### **(i) Personal Information – Privacy Legislation (section 3(q))**

IFIC, SSI and Canfin requested clarification of what constitutes “personal information” with respect to the requirement to provide authorization to disclose personal information to the MFDA under applicable privacy legislation. SSI added that clarification is required as to the scope of information that the client may expect to have divulged and under what circumstances.

With respect to section 4(o), SSI requested clarification as to what constitutes personal information for a non-personal entity or to whom the subsection applies.

## **MFDA Response**

*The Policy has been amended to generally reference the requirement to provide authorization to disclose information to the MFDA under applicable privacy legislation. With respect to what constitutes “personal information” and the scope of information that the client may be expected to disclose, Members should refer to the applicable provincial privacy legislation or federal legislation to determine their obligations.*

## **5. Identification of Certain Types of Accounts for Supervisory Purposes (section 5)**

IFIC, PFSL and SSI suggested amending this section to limit the identification of the accounts to those known to the Member as registered accounts, leveraged accounts and accounts operating under a limited trading authorization or power of attorney. IFIC, PFSL and SSI commented that a power of attorney, for example, could be attached to an account without a Member's knowledge.

IGM commented that the obligation to identify accounts operating under a power of attorney or limited trading authorization in favour of a registered salesperson should arise only where the Member had knowledge of the status of the account, and not retroactively, since this is a new requirement. IGM expressed the view that this requirement should apply only to accounts opened after the date the requirement comes into force.

Assante commented that the term "family members" is not defined in the Policy.

### **MFDA Response**

*This requirement applies to limited cases where an Approved Person holds a power of attorney for a client that is an immediate family member of the Approved Person and does not extend to every account operating under a power of attorney. This is a limited exception to the general prohibition on Members and Approved Persons accepting a power of attorney from clients in Rule 2.3.1. Rule 2.3.1(b) provides that the exception is subject to other conditions as prescribed by the Corporation. Member Regulation Notice MR-0031 – Powers of Attorney – Rule 2.3.1 – Exception for Family Members of Approved Persons ("MR-0031"), issued in October 2004, sets out compliance controls that must be complied with where this exception is relied upon. These compliance controls include the requirement that Members identify, on their records, accounts for which an Approved Person holds a general power of attorney. Recent amendments to Rule 2.3.1 also clarify the requirement for Approved Persons to notify the Member of the acceptance of a power of attorney from a family member and Members should have policies and procedures to ensure that this notification requirement is complied with. Accordingly, Members should have knowledge of such accounts to the extent that they permit their Approved Persons to accept a power of attorney from family members.*

*The term "family member" is referred to and defined in Rule 2.3.1(b) and in MR-0031 as "spouse, parent or child".*

## **6. Controls for Entry of KYC Information (section 7)**

IGM suggested that the requirement to detect and prevent inconsistencies between the KYC information used for account supervision and the KYC information provided by the client should be revised to read: "Such controls should provide an effective means to ensure that any updates to KYC information are recorded on the back office systems properly and accurately."

## **MFDA Response**

*This section is intended to apply to KYC updates as well as KYC information collected on account opening and, as such, MFDA staff believes that it is appropriate to specifically address this concern with the suggested wording.*

### **7. Timelines for Completing and Approving the NAAF – Transfer of Registered Salesperson (section 9)**

IFIC and SSI recommended removal of section 9, which sets out timelines for completing and approving the NAAF for clients of a registered salesperson transferring to the Member, stating that this section appears to apply only in the case of bulk transfers and that current procedures already require permission on bulk transfers.

## **MFDA Response**

*This section is intended to provide flexibility with respect to timelines for obtaining and approving NAAFs in situations where an Approved Person transfers to a Member with a large volume of accounts. The section provides that NAAFs must be prepared and completed within a reasonable time (but in any event no later than the time of the first trade) and approved no later than one business day after the NAAF is completed.*

### **8. Change of Registered Salesperson/Requirement to Review KYC (section 11)**

IFIC, IGM and Canfin recommended removal of the requirement for an Approved Person who has been assigned to service a client's account to review the KYC information as this requirement is redundant with Rule 2.2.1. IFIC commented that an update to KYC is initiated through a material change or a triggering point on the account and is not collected on a periodic basis. IFIC noted that the Rules triggering a suitability review establish that the KYC is current, as long as an annual notice is sent to the client and no material change known to the Member has occurred.

## **MFDA Response**

*MFDA staff agrees with the comment that the requirement to review the KYC information is already addressed by the requirement in Rule 2.2.1 to perform a suitability review and has deleted the requirement from the Policy.*

### **9. Changes to Know-Your-Client Information**

#### **(a) Client Information/KYC Information**

IFIC and SSI recommended clarifying that “client information” refers to KYC information and suggested the addition of “as defined in 2.2.4 (a)” following “client information” in sections 2, 3 and 7.

## **MFDA Response**

*The Policy has been amended to reference the definition in section 2.2.4(a).*

### **(b) Client Signature for Changes to Client Name, Address or Banking Information (section 5)**

IFIC recommended removal of section 5 that requires a client signature for changes to client name, address or banking information as it duplicates the requirements of Rule 2.2.4(d).

## **MFDA Response**

*MFDA staff recognizes that there may be overlap between the Policy and MFDA Rules. However, since the Policy is intended to set out a fulsome outline of Member obligations with respect to account supervision and there is no inconsistency in the noted duplication, the language of the section has not been amended.*

### **(c) Evidencing Other Material Changes (section 6)**

IFIC, SSI and Canfin recommended removal of section 6 that sets out requirements for evidencing material changes other than those referred to in the definition of 2.2.4(a) as they do not necessitate written client confirmation. IFIC and Canfin suggested that these changes should be addressed by the Member's internal risk management policies and not be the subject of MFDA regulation.

## **MFDA Response**

*Section 6 is intended to reference changes to client information other than changes to client name, address and banking information. Section 6 is intended to be limited to material changes as defined in Rule 2.2.4(a) and has been amended to clarify this requirement.*

### **(d) Timeline for Approval of Material Changes (section 7)**

IFIC and Canfin commented that the recommended timeframe for approval of material changes is unrealistic and suggested modifying the timeframe to "within a reasonable time, but in any event no later than the time of the next trade."

## **MFDA Response**

*The timeline proposed for approving material changes in client information (within one business day after the date on which notice of the change is received from the client) is reasonable and appropriate. Material changes that may impact on the suitability of investments in the account should be reviewed and approved in a timely manner. Further, the timeline required for the approval of material changes in client information is consistent with the timeline to review the suitability of investments in the account (i.e.*

no later than one business day after the date on which notice of the change in information is received by the client).

**(e) Requirement to Provide Current KYC Information (section 8)**

IFIC and SSI recommended removal of the requirement to provide clients with all KYC information for the account where any material changes are made, suggesting that these changes should be subject to Members' internal risk management controls and not MFDA regulation.

**MFDA Response**

*This section of the Policy has been amended to more specifically require that the client be provided with a document or documents specifying current risk tolerance, investment objectives, time horizon, income and net worth where material changes are made. This disclosure is necessary to demonstrate to the client how the information change has been recorded and to ensure that they understand the basis on which their account will operate and recommendations will be made going forward.*

**(f) Requirement to Record Date KYC Updated/Confirmed (section 9)**

IGM recommended that the requirement for the Member to track the date of the last update or confirmation of the KYC information be amended to accommodate Members that have a practice of periodically confirming current KYC on a negative confirmation basis.

SSI noted that it is very difficult to track when certain KYC information is updated and that a requirement to do so would not warrant the cost.

**MFDA Response**

*Members are required to record the date on which the client or the Approved Person took positive action to confirm that the KYC information is up to date. In accordance with the requirements of Policy No. 2, confirmation must be evidenced by client signature or by maintaining notes in the client's file with details of the client's instructions and providing the client with the opportunity to make corrections to the changes made.*

*With respect to the suggestion that the Policy be amended to accommodate periodic confirmation of KYC on a negative confirmation basis, MFDA Rules already accommodate this practice. Members are not prohibited from tracking the dates on which negative option confirmations have been sent to clients in routine mailings. However, unless the Member receives a positive confirmation from the client that the KYC information has either changed or not changed, Members should not be recording the dates on which negative confirmations have been sent to clients as the date upon which the KYC information was last updated or confirmed in accordance with Policy No. 2.*

*With respect to the comment that it is difficult to track when certain KYC information is updated, the proposed requirement is intended to apply only to material changes in client information. It is important to track updates to KYC information in order to maintain an audit trail for legal and regulatory purposes.*

## **10. Client Communications – Hold Mail**

IFIC and Canfin recommended removal of this section as hold mail requirements should be subject to Members' internal risk management controls and not MFDA regulation.

Assante indicated that, since there are occasions where clients may request to have mail held for periods longer than six months, this timeframe should be flexible to allow Members to have discretion.

### **MFDA Response**

*With respect to hold mail requirements, MFDA staff has identified significant risk of fraud arising from clients not receiving copies of their statements directly. Accordingly, the current requirement seems appropriate as it balances client protection with practical considerations. In addition, this is not a new requirement and Members are currently required to comply with these timeframes.*

## **11. Assessing Suitability of Investments and Leveraging Strategies (Section 3)**

### **(a) Obligation to Determine Suitability where Member not Involved in Leverage Strategy**

IFIC and Canfin suggested that the Rule be clarified to state that, whenever the client is using a leverage strategy and is unwilling to provide the required documentation, the Member's responsibility is limited to the request for the loan amount.

RMFI commented that, in cases where the client acted on its own to employ a leveraging strategy without the recommendation or involvement of the Member, the Approved Person's and Member's responsibility should reflect such limited involvement and be limited to assessing the suitability of the investments while knowing that the investments are leveraged. RMFI recommended that, in cases where the Approved Person has recommended a leveraging strategy but does not participate in obtaining the loan, the Approved Person and Member be responsible for ensuring that such a recommendation is suitable in light of the client's KYC information (i.e. risk tolerance). RMFI expressed the view that, in both these cases, recording the amount of the loan is sufficient to enable the Approved Person and the Member to determine the suitability of the investments based on the knowledge that the investments are leveraged. RMFI indicated that assessing the suitability of a specific loan based on limited knowledge and information is inappropriate and may in fact be incorrect and give clients a false sense of security regarding their credit situation. Where the Approved Person participates in the loan application process,

RMFI expressed the view that it is reasonable to require the Member to maintain copies of the loan application.

RMFI suggested that, similar to the disclosure that is proposed in Rule 2.2.5 with respect to the relationship disclosure requirements, the Member should be required to disclose its involvement in the loan process, if any, and disclose that the loan itself has not been assessed for suitability.

SSI recommended that the Rule be clarified to note that the requirements of this section are applicable only to open accounts of clients.

### **MFDA Response**

*If a leverage strategy is not recommended by an Approved Person but the Approved Person becomes aware the client is using borrowed funds to invest and the client refuses to provide the required documentation, the Member and the Approved Person are responsible for requesting that the client provide information regarding the loan amount, interest rate and payment requirements. All such information is pertinent in assessing whether leveraging is suitable for the client. Where a recommendation to borrow has been made and the Approved Person assists the client in obtaining financing, the Member or Approved Person must maintain a copy of the loan documents.*

*Where a client has acted on his or her own to employ a leverage strategy and the Member or Approved Person becomes aware of it, the Member and Approved Person are responsible for assessing both the suitability of the investments and the suitability of the leveraging strategy. Members and Approved Persons are responsible for acting in the best interest of clients and providing advice based on all essential facts pertinent to the client. If a Member or Approved Person becomes aware that a client has used borrowed funds to invest and determines that the strategy is not suitable or is not consistent with the client's KYC information, the Member and Approved Person have an obligation to inform the client of this fact.*

*The general requirements of the Policy with respect to assessing suitability of leveraging and maintaining documentation or making sufficient inquiries where leveraging is recommended is generally applicable to both registered and open accounts. The guidelines set out in MR-0069 with respect to specific criteria that should be considered when assessing suitability of leveraging are not intended to apply to loans obtained for the purpose of investing in a registered plan.*

#### **(b) Obtaining Details of Loan**

BMO commented that clients may express privacy concerns with respect to disclosing the specifics of a loan obtained at another financial institution. BMO also noted that requiring the client to deliver loan documentation could mislead the client into believing that the Member is somehow overseeing or vetting the terms of the loan on the client's behalf, an impression that may be heightened in the case of Members that are also bank dealers and related to the lending institution. BMO stated that this may expose the Member to client

complaints or requests for restitution if the client is forced to default, if the loan is called or if the loan documents contain an unfavourable provision of which the client later becomes aware. BMO added that, if bank dealer Members assert any sort of ownership or control over the loan documents, it may weaken the Member's ability to effectively convey that it is a separate legal entity from the bank.

### **MFDA Response**

*With respect to Members that are owned by or affiliated with banks, we understand that these organizations generally obtain client consent to share information among the entire corporate group. If the Approved Person became aware of a client borrowing from another financial institution, the Approved Person could either request the loan documentation or request information regarding the loan including the amount, interest rate and payment requirements.*

#### **(c) *Obligation to Obtain Copies of Loan Documents***

IGM agreed that Members should capture details of any loans used to finance investments through the Member where they are aware of the loan arrangement but expressed the view that this obligation should not extend to obtaining copies of the actual documents.

### **MFDA Response**

*The Member is only required to maintain copies of lending documents (including the loan application) where the Member or Approved Person has assisted the client in completing the loan application. Where the Member or Approved Person does not recommend leveraging but becomes aware of client's use of borrowed funds to invest, the Member or Approved Person can either obtain a copy of the loan documentation or request pertinent details with respect to the loan.*

#### **(d) *Communication of Criteria to Salespersons and Relevant Employees (section 4)***

IGM recommended that the requirement for Members to advise their registered salespersons and relevant employees of their criteria for selecting trades for review be amended to clarify that only a general description is required.

PFSL noted that it is inappropriate to share detailed information regarding how supervisory and disciplinary systems are applied as, in some cases, it may result in the salesperson altering behavior in an attempt to circumvent controls.

### **MFDA Response**

*It must be clear and transparent to salespersons what the Member's suitability guidelines are. For example, Members who use a percentage method to capture client risk tolerance may set a standard that advises Approved Persons that any trade that would result in the portfolio exceeding 10% of the standard risk tolerance may be considered*

*unsuitable and would be identified for review and inquiry. It is not expected that detailed supervisory procedures be communicated to Approved Persons but rather information regarding the types of trades that will result in suitability concerns, the inquiry process and disciplinary process where issues are not addressed.*

**(e) *Timeline for Suitability Assessment (section 5)***

IGM expressed the view that the timeline to perform the suitability assessment should be simply at the time of the next trade and that the reference to “within a reasonable time” should be removed.

**MFDA Response**

*Policy No. 2 requires the Approved Person to assess the suitability of investments in each client account within a reasonable time, but in any event no later than the time of the next trade. The determination of reasonable time in a particular instance will depend on the circumstances surrounding the event giving rise to the requirement to perform the suitability assessment. The Proposed Amendment is intended to ensure that a suitability review is performed as soon as reasonably possible following the trigger event. If the timeline for review was based solely on the timing of the first trade in the account after the transfer, there would be no change to the frequency of suitability assessments required currently under MFDA Rules.*

**(f) *Identification of Unsuitable Investments (section 6)***

IFIC expressed the view that the requirement to proactively provide a recommendation where unsuitable investments are identified in an account is excessive, particularly in a customer-directed channel. IFIC recommended that the Member’s responsibility should be limited to advising the client that the investment(s) is/are unsuitable.

**MFDA Response**

*Members and Approved Persons are responsible for acting in the best interest of clients and providing advice based upon all essential facts pertinent to the client. If a Member or Approved Person determines that the client’s portfolio is not suitable or in keeping with the client’s KYC information, the Member and Approved Person have an obligation to inform the client of this fact and provide recommendations to rebalance the investments in the account. If the client does not choose to follow the recommendations of the Approved Person, the Approved Person should document the advice given, as well as the fact that the client declined to follow the advice.*

**(g) *Maintaining Evidence of Suitability Assessments and Follow-up Action (section 7)***

PFSL noted that it agrees with the importance of maintaining such evidence but believes that this requirement would be best framed in a way that allows dealers to establish

processes and procedures for the retention of this evidence as well as the manner in which such evidence is to be maintained.

## **MFDA Response**

*This section does not specify processes and procedures for the retention of the required information or the manner in which it is to be maintained, so long as it is done in accordance with Rule 5 (Books, Records & Reporting).*

## **12. Branch and Head Office Supervision Requirements – General Comments**

### **(a) *Need for a Principles-Based Approach/More Flexibility***

A number of commenters recommended adopting a less prescriptive and more principles-based approach to account supervision. It was suggested that a more practical approach is to set out principles for account supervision and allow Members flexibility to develop systems that effectively supervise accounts and manage risk.

IFIC, SSI and Canfin recommended directional, but less prescriptive, requirements based on sampling.

IFIC and the Federation also suggested that the new requirements do not take into account the growing activity through the call center or internet distribution channels and stated that the MFDA's model of a branch with a branch manager is dated. IFIC and the Federation were of the view that, in this respect, the Proposed Amendments fall short of providing flexibility in the supervision structure and the way supervision is conducted.

Worldsource stated that advances in technology and operating systems make it possible for exception-based single-tier supervision of unsuitable trading and unusual trading activity. It was recommended that Members have flexibility to use technology to efficiently supervise and manage risk in a manner consistent with the core principles of detecting unsuitable trading and unusual trading activity. Worldsource suggested that the Policy be flexible and permit migration to a single tier, exception-based supervision of trading. IPG commented that it is possible, using technology, for all daily trade suitability reviews to be performed in a location other than the branch office and that Members should have this flexibility. Worldsource also suggested that the standards prescribed in Policy No. 2 with respect to account supervision will rapidly become obsolete and irrelevant to many Members.

RMFI suggested that Members be permitted to develop alternative, more comprehensive ways to conduct branch office supervision. For example, RMFI indicated that technological solutions have been developed for real-time monitoring of suitability at the point of sale that would render the prescriptive requirement to review suitability on the following day unnecessary. RMFI also suggested that Members be required to tailor their sampling to reflect their business risks (considering product offering, sales force

structure, technology, etc.) as opposed to following fixed sampling thresholds that may not be practical in all cases.

IGM suggested that the MFDA establish general binding parameters as to its expectations of Members supplemented by non-binding guidelines from MFDA staff setting out how Members can meet these obligations.

### **MFDA Response**

*As noted above, certain regulatory requirements were more principles-based prior to the development of the Proposed Amendments. Where MFDA staff has prescribed requirements in greater detail, for example, with respect to the trade review thresholds proposed in Policy No. 2, this has been in response to requests for more direction from Members. In addition, the prescribed requirements address compliance issues identified during reviews of our Members' branch supervision procedures and the issues identified by MFDA enforcement staff while assessing and investigating cases.*

*In developing the trade review thresholds, MFDA compliance staff examined the review thresholds currently used by Members and determined that 80% of Members are already conducting the proposed types of trade reviews.*

*MFDA staff encourages the use of technology by Members to implement alternatives that meet or exceed the minimum standards set in the Policy, such as real-time monitoring of suitability at the point of sale. Staff notes; however, that the majority of Members have not yet adopted such technology.*

*With respect to the recommendation that the MFDA establish a combination of binding parameters and non-binding guidelines, the current MFDA Rulebook uses a combination of prescriptive and principles-based approaches. The approach adopted in a particular area depends on the regulatory concerns being addressed.*

### **(b) Harmonization with IIROC**

IGM noted that many financial service providers have both MFDA Member dealers and IIROC dealers and that there is little harmonization between MFDA Rules and IIROC Rules regarding suitability assessment and branch and head office oversight. IGM commented that, if adopted, the MFDA approach will be more prescriptive and detailed than IIROC's, since it has adopted a more principles-based direction over the last few years.

### **MFDA Response**

*With respect to the comment that the MFDA and IIROC have different approaches to suitability and head office oversight regulation, it is noted that IIROC Policy No. 2 has been a requirement since 1993. As such, IIROC Members are familiar with their obligations and are accustomed to complying with the Policy as they have been subject to numerous compliance reviews since the Policy has been adopted. On the other hand, the*

*MFDA has only recently completed its second round of compliance reviews. As noted above, the issues identified through these reviews indicated that a more prescriptive approach was appropriate for MFDA Members.*

### **13. Branch Manager Daily Review**

#### **(a) Alternate Branch Managers**

IPG expressed concern that alternate branch managers only manage in the absence of the primary branch manager and that, as a result, the alternate branch manager would not necessarily be using the required and ongoing training and experience that is required to perform daily trade reviews. It was suggested that the amendments should allow alternate branch managers to perform the daily trade reviews of trades of the producing primary branch manager and vice-versa to ensure that both perform supervisory duties daily.

#### **MFDA Response**

*Cross-reviews between alternate and producing branch managers are permitted, but these reviews are considered branch office reviews (tier 1) and are not a substitute for head office review and assessment (tier 2).*

#### **(b) Initial Trades**

IGM commented that the requirement to review all initial trades is excessive and that there is no reason to single these trades out as a separate part of an integrated trade review process.

#### **MFDA Response**

*Members of the MFDA's Policy Advisory Committee suggested, and MFDA staff agrees, that including this requirement is useful and appropriate. The branch manager is currently required to review and approve new accounts and, as such, MFDA staff believes that the requirement to review all initial trades is not onerous. In addition, a review of all initial trades in new accounts is an existing requirement under Policy No. 2.*

#### **(c) Trades in Exempt Securities**

IFIC, SSI, BMO and Canfin expressed the view that the inclusion of GICs as exempt securities requiring review seems unnecessary and has not been explained.

#### **MFDA Response**

*This inclusion of GICs as exempt securities requiring review was a drafting oversight. Accordingly, this section of the Policy has been amended to clarify that exempt securities do not include GICs.*

***(d) Leveraged Trades/Leverage Recommendations/Accounts with Power of Attorney***

IFIC, IGM and Canfin expressed concern that there is limited ability for branch managers to track leverage recommendations. It was submitted that the requirement to review leverage recommendations for open accounts should be removed since the recommendation, unless and until executed, will not appear in a summary of trading activity.

IFIC and SSI recommended adding “If provided,” to the requirement to review the “trades in accounts of family members of registered salespersons operating under a power of attorney in favour of the registered salesperson”.

PFSL expressed concern that limiting reviews of accounts operating under power of attorney to those of family members of registered salespersons may insufficiently protect certain investors, noting that regardless of the relationship between the salesperson and the client, the potential for abuse exists when the salesperson is entrusted with power of attorney or limited trading authority. PFSL suggested that the phrase “of family members of registered salespersons” should be removed so that situations with similar potential for abuse receive similar degrees of scrutiny.

**MFDA Response**

*Members are only expected to review leverage recommendations made by their Approved Persons where the client takes steps to execute such recommendations (i.e. where the Approved Person has received documentation indicating an intention to proceed with the recommendation). As a best practice, Members should also review leverage recommendations prior to the client obtaining the borrowed funds in light of the difficulty in unwinding such arrangements.*

*The requirement to review accounts operating under a power of attorney applies to limited cases where an Approved Person holds a power of attorney for a client who is an immediate family member and does not extend to every account operating under a power of attorney. This is a limited exception to the general prohibition on Members and Approved Persons accepting power of attorney from clients in Rule 2.3.1. MR-0031 sets out compliance controls that must be complied with where this exception is relied upon.*

***(e) Trades over \$1,000 in Moderate-High/High-Risk Investments***

IFIC and PFSL expressed the view that the \$1000 trade review threshold for moderate-high or high-risk investments is arbitrary and unexplained. IFIC stated that threshold levels will become obsolete in time and should not be prescribed by a Rule. SSI noted that the number of moderate-high-risk investments (using standard deviation measures) is vast and may lessen the intended impact of the Rule.

IGM also disagreed with the \$1,000 trade review threshold and recommended that Members be given flexibility to determine which trades in moderate-high or high-risk investments should be reviewed. IGM suggested that if a specific threshold is maintained, it should be higher than \$1,000.

Assante expressed the view that requiring branch managers to review all trades over \$1000 in moderate-high or high-risk investments is a considerably low threshold and will most likely not result in identifying a greater number of unsuitable trades. Assante indicated that previous guidance was provided to include a minimum threshold of \$2,500 which it has found to be highly effective in its branch trade surveillance.

#### **MFDA Response**

*The concerns of the commenters with respect to the \$1,000 threshold for moderate to high-risk investments are acknowledged and, accordingly, the threshold has been increased to \$2,500. The thresholds will be reviewed from time to time to ensure that these limits remain relevant.*

#### **14. Review of Redemptions**

##### **(a) Suitability of Redemption with regard to the Composition of the Remaining Portfolio**

IFIC, SSI and Canfin recommended changing the requirement to assess “the suitability of the redemption with regard to the composition of the remaining portfolio” to read “the suitability of the portfolio at the time of the next trade, if, after a redemption, the composition of the portfolio does not match the KYC.”

#### **MFDA Response**

*If a redemption and subsequent withdrawal results in the investments in a client’s account becoming unsuitable, the impact of the redemption must be discussed with the client prior to the redemption. If the assessment was done at the time of the next trade, the portfolio may be inconsistent with the KYC information for a significant period of time.*

##### **(b) Impact and Appropriateness of any Redemption Charges**

With respect to the requirement to assess “the impact and appropriateness of any redemption charges”, IFIC, SSI and Canfin recommended clarifying the term “appropriateness” of redemption charges and recommended adding “excessive” before the words “redemption charges”.

PFSL commented that the current wording of this section may represent an excessive requirement for branch managers, as redemptions may occur without the representative being directly involved. PFSL recommended that transfers of assets to another dealer or transactions completed at the fund manager level by the client not fall under this

requirement and suggested that the section be revised to clarify that the requirement only applies to branch managers when the representative is directly involved in the redemption prior to its completion.

IGM expressed the view that the requirement to assess the impact and appropriateness of any redemption charges is best conducted as part of the trend review process at head office as opposed to the daily review at the branch office.

### **MFDA Response**

*The requirements of this section are not intended to address only activities that are engaged in for the exclusive purpose of maximizing economic benefit to the Approved Person (i.e. churning), but are also intended to capture other inappropriate redemption charges arising from matters such as Approved Person error. In addition, it is noted that redemption charges do not have to be excessive to be inappropriate.*

*It is acknowledged that the requirement to assess the appropriateness of the redemption should be limited to circumstances where the Approved Person is directly involved in the redemption.*

*Review at both the branch and head office levels is necessary to ensure adequate assessment of the impact and appropriateness of redemption charges. Head office reviews are performed using higher dollar thresholds and thus do not duplicate the review performed at the branch office level. The more detailed branch office review provides an added check to identify errors that may not be apparent through the head office review.*

### **(c) Identification of Possible Outside Business Activity**

IFIC, SSI, BMO and Canfin recommended removal of the requirement to assess “possible outside business activity where money may be leaving the Member for reinvestment into other potentially inappropriate or unauthorized investments”. These commenters expressed the view that monitoring subsequent purchases at another firm is not appropriate and not a duty that a branch manager can or should assume. BMO added that, upon client transfer to another institution, it is not uncommon for the trade to be initiated by that institution and processed through the Member’s back office without any involvement from the Member’s branch. While the transfer-out would appear on the trade review report, the other institution or the investments being transferred into would not be identified. Further, BMO noted that this provision assumes that the branch manager will be sufficiently familiar with the investment product being transferred into the account to determine whether it is inappropriate for the client. IFIC, SSI and BMO commented that this requirement is too vague and may not be enforceable.

### **MFDA Response**

*This section does not require branch managers to monitor subsequent purchases at another firm. Significant redemptions in a client’s account where funds are leaving the*

*Member may either result in the account falling out of line with the investor's stated risk tolerance/investment objectives or may indicate that the Approved Person is engaged in an outside business activity of which the branch manager should be aware.*

*The branch manager should seek to determine if the client's KYC information has changed and, if it has not, assess the impact of the redemption on the client's account in relation to both the investments remaining in the account and the existing KYC information. Similarly, if information with respect to where the funds will be invested can be obtained, the branch manager should seek to assess the suitability of the proposed new investments in relation to the investments remaining in the client's account and the existing KYC information.*

**(d) Identification of Possible Churning**

IFIC, SSI and Canfin expressed the view that the requirement to identify potential churning requires trend analysis (as described in Section VI) and may not be apparent through review of daily trades and recommended removal of this requirement.

**MFDA Response**

*The Policy has been amended to clarify that the requirements of this section contemplate a monthly or quarterly rather than daily review of trades to identify potential churning activity.*

**15. Branch Manager Assessment of Suitability where Material Change in KYC Information**

IFIC, PFSL and SSI recommended removal of the requirement for the branch manager to assess investment suitability upon a material change in the client's KYC information as it is already assessed at the advisor level. PFSL noted that such review could be duplicative and stated that, in situations where the advisor has conducted a suitability assessment following a material change, a secondary review by the branch manager should only be required where the advisor's assessment does not receive approval.

In addition, PFSL expressed the view that the inclusion of the one-business-day deadline for the suitability assessment is arbitrary and unnecessarily prescriptive. PFSL noted that, since the situation described is not actually a transaction, a pressing material risk may not exist at the time the Member becomes aware of a material change and, as a result, this provision should be revised so that the assessment is performed "promptly or within a reasonable time".

IGM commented that branch managers are already required to approve changes to KYC information and that requiring a suitability review as well would prove onerous without a commensurate benefit and may divert time from more useful oversight activities.

## **MFDA Response**

*In response to the comments, the Policy has been amended to require the branch manager to perform a suitability review on a sample basis where a material change results in a significant decrease in the client's risk tolerance, time horizon, income or net worth or more conservative investment objectives. In addition, the requirement for head office to perform a suitability assessment on a sample basis where there is a material change in client information has been removed.*

## **16. Head Office Supervision Requirements**

### **(a) Head Office Daily Reviews**

IGM commented that the proposed changes to the head office review requirements largely duplicate the reviews done at the branch level, although with some higher thresholds. IGM expressed the view that this is not an effective use of head office resources that would be better directed at supplementing what the branch manager is doing (such as the excessive switching and churning reviews). IGM recommended that, if the requirements are retained, the thresholds be increased.

IPG sought clarification with respect to the suitability reviews required by head office and suggested that the review should focus only on exceptional trades of concern, such as out of province trades, exempt products, leveraging reviews and sample branch manager trades and that general trade suitability should be left under the sole responsibility of the branch office.

BLG commented that the requirement to review all trades over \$5,000 for all exempt securities, regardless of their nature, risk characteristics or their issuer may be burdensome for dealers whose clients have and trade significant positions in investments issued or guaranteed by Canadian governments and their agencies (for example, Canada Savings Bonds) or financial institutions regulated by the Office of the Superintendent of Financial Institutions (for example, GICs). The commenter suggested that these types of investments be explicitly excluded from this requirement.

Assante commented that, in difficult market times, many clients switch into money market funds for safety. It recommended that money market funds be exempt from reviews in redemptions greater than \$10,000.

With respect to the daily review requirement for trades over \$10,000 in other investments (excluding money market funds), SSI noted that if money market funds are excluded than GICs and cash transactions should also be excluded.

## **MFDA Response**

*With respect to comments indicating that the proposed head office reviews are duplicative of those performed at the branch level, it is noted that head office reviews are*

*intended to detect unsuitable investments and excessive trading and serve the purpose of exercising effective oversight of branch office operations. Higher trade thresholds and sampling of suitability of investments on a transfer-in of assets allow such reviews to be less detailed than those required at the branch level, while still being effective as an oversight review for unsuitable investments and excessive trading.*

*The reference to exempt securities in the Policy was not intended to include GICs and has been clarified. The Policy has also been amended to revise the \$10,000 threshold in respect of low risk investments to \$50,000.*

**(b) *Suitability Review of Accounts where Assets Transferred in/Material Changes to Client Information***

IGM recommended deleting section 5 that imposes an obligation on Members to review the suitability of investments in an account on a sample basis where assets have been transferred into an account or where there is a material change in client information. IGM commented that this obligation should only be triggered where a trade has occurred.

Assante expressed the view that it is excessive to require the salesperson, branch manager and head office to review an account for suitability if there is a material change in a client's KYC form. It indicated that this review is currently the branch manager's responsibility and suggested that head office should not be required to examine such accounts.

BMO expressed the view that this requirement seems redundant given that the MFDA also intends to prescribe trade review thresholds for all transactions. BMO questioned the added value of sampling transfer-ins that fall outside the standard trade review process, unless a transfer-in, leveraged trade or account with a power of attorney meets the daily trade review filtering criteria (which will include higher-risk investments and exempt securities).

In addition, BMO noted that sampling trades "where there has been a material change in client information" is not possible given the definition of material change in client information in Rule 2.2.4. BMO submitted that the definition refers to information "that could reasonably result in changes" to certain KYC information. BMO added that, unless there is an actual material change to the KYC information and the resulting transaction meets the filtering criteria, the trade would not be picked up on the trade review report. BMO also noted that the reference to "products not normally sold by the Member" in this section is not helpful as a trade reviewer cannot be expected to determine on a case-by-case basis whether a particular product is normally sold across a large sales force.

**MFDA Response**

*As noted above, the Policy has been amended to remove the requirement for head office to perform a suitability assessment on a sample basis where there is a material change in client information. With respect to the transfer-in of assets, Approved Persons are*

*required to perform a suitability review but there is no requirement for branch manager review. Accordingly, it is appropriate that head office perform a suitability review on a sample basis where clients have transferred assets into the account as part of their oversight function to ensure that the suitability reviews have been performed properly.*

*With respect to comments indicating that the sample-basis head office review should not be required unless triggered by trade, it is not appropriate to wait until a trade has occurred to assess suitability in these circumstances. Where an individual transfers assets into an account at a Member and becomes a client of the Member, the Member is earning compensation and has a responsibility to provide financial advice and assess whether the assets transferred in are suitable for the client. With respect to comments indicating that the proposed sample-basis head office review seems redundant given the proposed trade review thresholds, we note that the trade review thresholds have been amended and, as a result, the Policy does not require the review of all trades.*

*As noted above, the definition of material change has been amended to delete the reference to “that could reasonably result in changes”.*

*With respect to the comment indicating that the reference to “products not normally sold by the Member” is not helpful in light of the volume of products sold across a large sales force, we note that we have deleted the reference to “normally”. To the extent that an asset is transferred into a client account which is not sold by the Member, this should be easily determined.*

**(c) Identification of Trends in Trading Activity – General Comments**

PFSL noted that this section is unnecessarily prescriptive and, given the operational diversity among Member firms, each company should be entrusted to design methods for addressing risk with respect to churning that are appropriately designed for their operations.

**MFDA Response**

*Under Member Regulation Notice MR-0065 – Churning (“MR-0065”), Members are advised to have policies and procedures to detect instances of churning or excessive trading and properly address these situations. Members should also generate and review reports showing trading and commission trends on a periodic basis (generally monthly or quarterly, taking into consideration the Member’s trading volume). MFDA staff has received inquiries from Members requesting more detail in respect of the policies and procedures that would be appropriate under MR-0065 and the Proposed Amendments have been developed in response to such requests. If a Member has a specific business structure in which the risk of churning is not present (e.g. where Approved Person is compensated exclusively on a salary basis), the review of accounts generating more than \$1,500 within the month and the quarterly review of commission reports would not apply. However, the requirement to perform trend analysis and quarterly reviews of assets under administration (“AUA”) reports would still be applicable.*

**(d) Review of Accounts Generating Commissions Exceeding \$1,500 per Month**

IFIC and Canfin suggested that the main objective of the requirement to review all accounts generating commissions of more than \$1,500 within the month is to monitor accounts where excessive trading has occurred for the sole benefit of the registered representative. It was noted that a \$1,500 commission may be produced by one \$30,000 trade. IFIC also suggested that, in instances of high market volatility, it may be prudent for registered representatives to rebalance their client's portfolios and minimize risk levels and, in such cases, increasing the volume of trading is in the best interests of the client. IFIC and Canfin expressed the view that the requirement will generate an excessive number of false positives, each of which will require time to review. IFIC and Canfin recommended increasing the threshold to \$3,000 to correspond with IIROC Rule 2500 IV (B).

The ACCP expressed the view that review requirements for all accounts with more than five trades per month and accounts generating commissions greater than \$1,500 will result in an unnecessarily high number of exceptions to be reviewed. It indicated that accounts with more than five trades and more than \$1,500 in commissions per month are not outside the realm of normal trading patterns, especially during RRSP season. The ACCP suggested that Members be permitted to establish their own thresholds based on their specific dealer models. If thresholds are prescribed, the ACCP recommended that these thresholds be increased to \$2,500 in commissions and five purchases per month per account.

IGM recommended that the requirement to review all accounts generating commissions greater than \$1,500 per month be removed. IGM expressed the view that this reporting is of very limited use and general commission trend monitoring, which is captured in other items in the section, is more effective.

**MFDA Response**

*The \$1,500 threshold is intended to recognize the fact that, based on data provided by large mutual fund dealers, the dollar value of the average mutual fund trade is generally quite low. In addition, unlike equities traded by IIROC Members, mutual funds are generally long-term investments that should not, in the normal course, be frequently traded and thus should not generate commissions higher than \$1,500 within one account in a month.*

*With respect to the suggestion that the review threshold be increased to \$3,000 to correspond to IIROC Rules, it should be noted that IIROC Rule 2500 requires branch office review of all client statements that produced commissions of \$1,500 or more for the month as well as head office review of all client statements that generated more than \$3,000 in commissions during the month. Given that head office is required to perform a quarterly trend analysis of commissions and AUA under MFDA Policy No. 2, it appeared more appropriate to have head office perform the monthly commission review of accounts generating commissions greater than \$1,500 and unnecessarily duplicative to*

*have it performed at the branch level. However, Members may choose to adopt IIROC's two-tier review as an alternative approach to meet the minimum standards of Policy No. 2, provided they have controls and procedures in place to ensure that commission reviews are implemented at the branch level.*

*The section that refers to an account review where there are more than five trades per month is merely intended as an example of a procedure to identify excessive trading or switching between funds and has been included to provide guidance to Members.*

*The review of all accounts generating commissions exceeding \$1,500 per month is required on a monthly basis to allow for a more timely review than commission trend monitoring that is required on a quarterly basis.*

**(e) Revenue versus Commissions**

With respect to the review of commission reports to detect potential inappropriate conduct, BMO noted that Members compensate their sales force using means other than traditional commissions. BMO noted that mutual fund salespersons of bank-owned Members are salaried employees with various incentive pay arrangements that do not fit within the traditional commission structure and that commissions cannot be carved out from the salesperson's overall pay. BLG reiterated these comments, submitting that it may be more appropriate to consider "revenue" in section 2 under "Identification of Trends in Trading Activity" as opposed to "commissions" alone in order to capture all types of remuneration.

**MFDA Response**

*The purpose of the requirement is to identify trading activity or strategies that are being engaged in exclusively for the purpose of maximizing the economic benefit to the Approved Person. Although a review of commission reports would not be applicable to Approved Persons who are salaried employees, the review of AUA reports as required under Section 2 of Part VI of the Policy would apply.*

**(f) Excessive Trading**

RMFI suggested that the MFDA clarify the term "excessive trading" and questioned whether it refers to churning or short-term trading.

IGM suggested that the requirement to review trends to identify excessive trading or switching should be amended to require a review where trading takes place on five different days in a month as opposed to where there are more than five trades in a single month.

**MFDA Response**

*"Excessive trading" is not intended to refer exclusively to one type of activity and can be an indicator of a number of potential problems including, as noted, unauthorized trading,*

*lack of suitability or churning. Excessive trading would also include short-term trading, to the extent that such trading is inappropriate or an indicator of potentially inappropriate activity in the specific circumstances.*

*As noted above, the reference to five trades per month has been included for the purpose of providing guidance to Members and is intended only as an example.*

**(g) *Head Office Supervisory Reviews to Be Completed in 21 Days***

IFIC noted that increased supervision requirements make meeting review checks within 21 days impractical and recommended a 30-day requirement. IGM recommended clarification that not all issues must be resolved within the 21-day period.

**MFDA Response**

*The Policy has been amended to require that reviews be completed within 30 days of the last day of the period being reviewed.*

*This section is not intended to require that all issues be resolved within the prescribed period, but Members must have a plan in place to address the identified issues.*

**17. Transition Periods**

A number of commenters noted that the proposed changes would require significant development time for systems changes, new documentation and retraining and restructuring at all levels including representatives, branch managers and administration. IGM also noted that the required transition time will be highly dependent on other businesses in the financial services industry, in particular mutual fund manufacturers and back office system service providers that will be providing necessary data for Members to meet the proposed performance reporting requirements.

IFIC, SSI and Worldsource recommended an 18-month transitional period for the implementation of amendments relating to suitability assessments triggered by certain events. PFSL commented that a transition period of up to two years might be necessary and noted, by way of example, that the shift from transaction-level to account-level suitability assessments represents a substantial change that will be accompanied by an equally substantial effort to establish corresponding compliance structures.

RMFI suggested a minimum 12-month transition period to allow Members time to become fully compliant with the new requirements. The ACCP suggested the following specific transition periods: (i) where systems must be developed, a one-year period; (ii) where Members must develop forms, policies, procedures and implementation plans, a 15-month period; (iii) where systems must be developed for new accounts, KYC and other account documents, one year from the first trigger (trade, transfer, reassigned Approved Person or material change); and (iv) where Members must develop forms, policies, procedures and implementation plans for new accounts, KYC and other account

documents, a 15-month period from the first trigger (trade, transfer, reassigned Approved Person or material change).

**MFDA Response**

*MFDA staff is aware that systems changes may be required to implement the Proposed Amendments and will carefully consider comments received to ensure that transition periods allow sufficient time for the implementation of any such changes.*

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