

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

PROPOSED AMENDMENTS TO MFDA RULE 2.2.1 (“KNOW-YOUR-CLIENT”)

AND

MFDA POLICY NO. 2

MINIMUM STANDARDS FOR ACCOUNT SUPERVISION

I. OVERVIEW

A. Current Rule and Policy

MFDA Rule 2.2.1(c) currently requires 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 the essential facts relative to the client and any investments within the account.

MFDA Policy No. 2 establishes minimum industry standards for the supervision of client accounts and expands upon the basic requirements contained in Rule 2. Policy No. 2 currently requires Members to have policies and procedures with respect to their suitability obligations, including criteria for the purpose of assessing the suitability of leverage recommendations.

Amendments to Rule 2.2.1, which were approved by Members in December 2010 and are currently subject to a transition period, require Members and Approved Persons to assess the suitability of investments within each client’s account when certain triggering events occur. In conjunction with these amendments, revisions were also made to MFDA Policy No. 2 to clarify the responsibilities of Members and Approved Persons in discharging their suitability obligations.

B. The Issues

The requirement to assess suitability under Rule 2.2.1 has always been interpreted by MFDA staff as including a requirement to assess leverage suitability. As currently drafted, the Rule does not expressly refer to recommendations to borrow to invest or transactions involving the use of borrowed funds.

Policy No. 2 sets out a general obligation for Members to establish policies and procedures to assess the suitability of leverage, but does not set minimum criteria in this area. Member Regulation Notice MR-0069 – *Suitability Guidelines* (“MR-0069”), issued on April 14, 2008, sets out guidelines and factors that MFDA staff believes Members and Approved Persons should consider in assessing the suitability of leverage. Unlike MFDA Rules and Policies, Member Regulation Notices are not prescriptive and are intended to provide

guidance only.

C. Objectives

The proposed amendments are intended to clarify that the suitability obligations in Rule 2.2.1 with respect to investments apply equally to leverage strategies, and codify minimum standards for Members and Approved Persons in assessing the suitability of client leveraging.

D. Effect of Proposed Amendments

The effect of the proposed amendments will be to clarify the regulatory intent of Rule 2.2.1 in respect of the obligation for Members and Approved Persons to assess leverage suitability, expressly establish transparent minimum regulatory standards that are based on key criteria used in assessing leverage suitability, and ensure a consistent level of investor protection.

II. DETAILED ANALYSIS

A. Relevant History

As noted above, MR-0069 provides guidance on assessing leverage suitability. The Notice reminds Members that leverage is not suitable for all investors and of the Member's responsibility to ensure that all leveraging recommendations are suitable for the client and in keeping with the client's Know-Your-Client ("KYC") information, in accordance with MFDA Rule 2.2.1. In response to requests from Members for more guidance, the Notice also sets out key factors to consider when assessing leverage suitability. At the time the Notice was issued, MFDA staff explained that the Notice reflects existing regulatory obligations, as well as new guidelines in certain areas, which would result in future corresponding Rule and Policy amendments.

B. Proposed Amendments

Proposed amendments to Rule 2.2.1(c) will clarify that the obligation for Members and Approved Persons to ensure that each order accepted, or recommendation made, for any account of a client, is suitable includes recommendations to borrow to invest. Proposed amendments to Rule 2.2.1(d) will clarify that, where a transaction proposed by the client is not suitable for the client, Member and Approved Person obligations to advise the client of this fact, and maintain evidence of the advice, apply to transactions involving the use of borrowed funds. In addition, proposed Rule 2.2.1(f) will clarify that Members and Approved Persons are required to use due diligence to ensure that the suitability of the use of borrowing to invest is assessed on certain trigger events consistent with the amendments under Rule 2.2.1(e) with respect to investment suitability:

- whenever the client transfers assets purchased using borrowed funds into an account at the Member;

- whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
- by the Approved Person, where there has been a change in the Approved Person responsible for the client's account at the Member.

Where the use of borrowing to invest by the client is determined to be unsuitable, proposed Rule 2.2.1(f) will also require the Member, or the Approved Person, to advise the client and make recommendations to address the inconsistency between the use of borrowed funds and the essential facts relative to the client, and maintain evidence of such advice and recommendations.

Amendments have been proposed to Policy No. 2 to reflect the proposed requirements under Rule 2.2.1(f). The proposed amendments also include the following:

- Clarification that the suitability of leverage must be assessed having regard to the client's investment knowledge, risk tolerance, age, time horizon, net worth, income, and investment objectives;
- Minimum criteria that would require further supervisory review and investigation of leverage recommendations;
- The type of documents Members will be required to review and maintain to facilitate proper supervision of a leveraging strategy;
- The respective obligations of the registered salesperson and branch and head office supervisory staff in assessing the suitability of investments and leveraging strategies; and
- Clarification that the obligation to review leveraged trades and leverage recommendations at the branch and head office applies to accounts other than registered retirement savings plans and registered education savings plans.

Attached to this Notice, as Schedule "A", is a chart summarizing the respective obligations of Approved Persons and branch and head office supervisory staff with respect to suitability reviews. The chart will also be included in a companion Member Regulation Notice to the proposed amendments, which will be published once the amendments become effective.

C. Issues and Alternatives Considered

Consideration was given to clarifying the obligation to assess leverage suitability under Rule 2.2.1 without the additional proposed amendments to Policy No. 2 that would codify those aspects of MR-0069 that the MFDA believes should be minimum requirements. However, as noted above, most Members currently comply with the guidelines in MR-0069 and MFDA staff is of the view that including minimum criteria in the Policy will ensure consistent and objective minimum industry standards for assessing leverage suitability for the benefit of Members and investors.

D. Comparison with Similar Provisions

IIROC

Current Rules of the Investment Industry Regulatory Organization of Canada (“IIROC”) with respect to suitability do not specifically reference a requirement to assess the suitability of leverage strategies. IIROC Rule 1300 (Supervision of accounts) generally requires that IIROC dealer members use due diligence to ensure, when accepting an order or recommending to a client the purchase, sale, exchange, or holding of any security, that any such acceptance/recommendation is suitable for the client based on the client’s current financial situation, investment knowledge, objectives, and risk tolerance.

On January 7, 2011, IIROC republished for comment proposals to implement the core principles of the Client Relationship Model. The proposed amendments were accompanied by a draft Guidance Note, “Know Your Client and Suitability”. With respect to compliance with suitability assessment requirements, the draft Guidance Note provides that the regulatory obligation to ensure that orders and recommendations are suitable includes not only an obligation to ensure that the specific security is suitable for the client, but also that the order type, along with the *trading strategy recommended* and/or adopted are also suitable for the client (emphasis added).

The proposed IIROC amendments include an obligation to assess the suitability of investments in the client’s account on certain trigger events consistent with those under MFDA Rule 2.2.1. However, there is no similar requirement under the proposed IIROC Rules to also assess the suitability of leverage on the trigger events.

FINRA

On November 17, 2010, the Securities and Exchange Commission (“SEC”) approved proposals made by the Financial Industry Regulatory Authority (“FINRA”) to adopt know-your-customer and suitability obligations for the consolidated FINRA Rulebook. New FINRA Rule 2111 (Suitability) requires that a firm or associated person have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer’s investment profile.

FINRA Regulatory Notice 11-25, issued on May 18, 2011, provides guidance in respect of the new rules implementing FINRA’s know your customer and suitability proposals, and notes that these Rules are to be implemented on July 9, 2012.

The Notice clarifies the scope of the term “strategy” as used in Rule 2111, noting that the Rule explicitly states that “strategy” should be interpreted broadly. The Rule would cover a recommended investment strategy regardless of whether the recommendation results in a securities transaction or even references a specific security or securities. By way of

example, the Notice provides that the suitability obligations under Rule 2111 would cover a recommendation to purchase securities using margin or liquefied home equity.

E. System Impact of Amendments

As noted, the proposed amendments codify the expectations of the MFDA regarding the minimum standards that must be followed by Members and Approved Persons when assessing the suitability of client leveraging. These standards were initially introduced in MR-0069 and are already being complied with by most Members. Accordingly, it is not anticipated that there will be a significant system impact upon these Members as a result of the proposed amendments. For those Members that do not currently have guidelines in place to assess leverage suitability, there may be significant system changes required to comply with the proposed amendments.

F. Best Interests of the Capital Markets

The Board has determined that the proposed amendments are consistent with the best interests of the capital markets.

G. Public Interest Objective

The proposed amendments establish clear minimum regulatory standards that are based on key criteria used in assessing leverage suitability and will ensure a more consistent level of investor protection.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed amendments will be filed for approval with the Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on June 9, 2011.

D. Effective Date

The proposed amendments will be effective on a date to be subsequently determined by the MFDA.

IV. SOURCES

MFDA Rule 2.2.1 (“Know-Your-Client”)

MFDA Policy No. 2 *Minimum Standards for Account Supervision*

IROC Proposals to implement the core principles of the Client Relationship Model (Request for Comments – Republication dated January 7, 2011)

FINRA Regulatory Notice 11-25 – Know Your Customer and Suitability

V. REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within **90** days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Anne Hamilton, Senior Legal Counsel Capital Markets Regulation Division, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at www.mfda.ca.

Questions may be referred to:

Paige Ward
Director, Policy & Regulatory Affairs
Mutual Fund Dealers Association of Canada
(416) 943-5838

DM#255612v3

SCHEDULE “A”

Suitability Review Trigger Event	Investment Suitability			Leverage Suitability		
	Registered Salesperson	Branch Office	Head Office	Registered Salesperson	Branch Office	Head Office
Transfers – Rule 2.2.1(e)(f)(i)	Review all accounts within a reasonable time, but in any event no later than the time of the next trade	No review	Review client accounts on a sample basis within a reasonable time, but in any event no later than the time of the next trade	Review all accounts in a timely manner, as soon as possible after the transfer in accordance with the circumstances, but in any event no later than the time of the next trade	No review	Review all accounts in a timely manner, as soon as possible after the transfer in accordance with the circumstances, but in any event no later than the time of the next trade
Material Change – Rule 2.2.1(e)(f)(ii)	Review all accounts no later than one business day after notice of the change in information is received from the client	Review accounts where Member becomes aware of material change that results in a significant decrease in client risk tolerance, time horizon, income, net worth, or more conservative investment objectives, no later than one business day after notice of the change in information is received from the client	No review	Review all accounts no later than one business day after notice of the change in information is received from the client	Review accounts where Member becomes aware of material change that results in a significant decrease in client risk tolerance, time horizon, income, net worth, or more conservative investment objectives, no later than one business day after notice of the change in information is received from the client	No review

Suitability Review Trigger Event	Investment Suitability			Leverage Suitability		
	Registered Salesperson	Branch Office	Head Office	Registered Salesperson	Branch Office	Head Office
Change in Registered Salesperson – Rule 2.2.1(e)(f)(iii)	Review all accounts within a reasonable time, but in any event no later than the time of the next trade	No review	No review	Review all accounts in a timely manner, as soon as possible after the transfer in accordance with the circumstances, but in any event no later than the time of the next trade	No review	No review
Order or Recommendation – Rule 2.2.1(c)	Review prior to recommendation or acceptance of the order	Review: <ul style="list-style-type: none"> • initial trades, • trades in: exempt securities, accounts of family members of registered salespersons operating under a POA in favour of the registered salesperson, • redemptions over \$10,000, and • trades over: \$2,500 in moderate-high or high risk investments, \$5,000 in moderate or medium risk investments, and \$10,000 in all other investments, one business day after trade 	Review: <ul style="list-style-type: none"> • redemptions over \$5,000, • trades over \$5,000 in exempt securities (excluding GICs), moderate-high or high risk investments, • trades over \$10,000 in moderate or medium risk mutual funds, and • trades over \$50,000 in all other investments (excluding money market mutual funds), one business day after trade 	Review prior to recommendation or acceptance of the order	Review all leveraged trades or recommendations for all accounts other than RRSPs or RESPs one business day after trade/ recommendation	Review all leveraged trades or recommendations over \$5,000 for all accounts other than RRSPs or RESPs one business day after trade/ recommendation

SCHEDULE “B”

MFDA Rule 2.2.1 (“Know-Your-Client”)

On June 9, 2011, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 2.2.1 (“Know-Your-Client”):

2.2 CLIENT ACCOUNTS

2.2.1 **"Know-Your-Client"**. Each Member and Approved Person shall use due diligence:

- (a) to learn the essential facts relative to each client and to each order or account accepted;
- (b) to ensure that the acceptance of any order for any account is within the bounds of good business practice;
- (c) to ensure that each order accepted or recommendation made, including recommendations to borrow to invest, for any account of a client is suitable for the client based on the essential facts relative to the client and any investments within the account;
- (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction, including a transaction involving the use of borrowed funds, proposed by a client is not suitable for the client based on the essential facts relative to the client and the investments in the account, the Member or Approved Person has so advised the client before execution thereof and the Member or Approved Person has maintained evidence of such advice;
- (e) to ensure that the suitability of the investments within each client’s account is assessed:
 - (i) whenever the client transfers assets into an account at the Member;
 - (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
 - (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client’s account at the Member;and, where investments in a client’s account are determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address any inconsistencies between investments in the account and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations;
- (f) to ensure that the suitability of the use of borrowing to invest is assessed:
 - (i) whenever the client transfers assets purchased using borrowed funds into an account at the Member;

- (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
- (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member;

and, where the use of borrowing to invest by the client is determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address the inconsistency between the use of borrowed funds and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations.

SCHEDULE "C"

MFDA POLICY NO. 2

MINIMUM STANDARDS FOR ACCOUNT SUPERVISION

On June 9, 2011, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Policy No. 2 *Minimum Standards for Account Supervision*:

Amendments to Policy No. 2

This version of Policy No. 2 is subject to a transition period. As of December 3, 2011, the Policy will read as follows:

Introduction

This Policy establishes minimum industry standards for account supervision. These standards represent the minimum requirements necessary to ensure that a Member has procedures in place to properly supervise account activity. This Policy does not:

- (a) relieve Members from complying with specific MFDA By-laws, Rules and Policies and securities legislation applicable to particular trades or accounts; or
- (b) preclude Members from establishing a higher standard of supervision, and in certain situations a higher standard may be necessary to ensure proper supervision.

To ensure that a Member has met all applicable standards, Members are required to know and comply with MFDA By-laws, Rules and Policies as well as applicable securities legislation which may apply in any given circumstance. The following principles have been used to develop these minimum standards:

- (a) The term "review" in this Policy has been used to mean a preliminary screening designed to detect items for further investigation or an examination of unusual trading activity or both. It does not mean that every trade must be reviewed. The reviewer must use reasonable judgement in selecting the items for further investigation.
- (b) It has been assumed that Members have or will provide the necessary resources and qualified supervisors to meet these standards.
- (c) The initial compliance with the know-your-client ("KYC") rule and suitability of investment requirements is primarily the responsibility of the registered salesperson. The supervisory standards in this Policy relating to KYC and suitability are intended

to provide supervisors with a checklist against which to monitor the handling of these responsibilities by the registered salesperson.

Members that seek to adopt policies and procedures relating to branch and head office supervision or the allocation of supervisory activities that differ from those contained in this Policy must demonstrate that all of the principles and objectives of the minimum standards set out in this Policy have been properly satisfied. Further, any such alternative policies and procedures must adequately address the risk management issues of the Member and must be pre-approved by MFDA staff before implementation.

Supervisory staff has a duty to ensure compliance with Member policies and procedures and MFDA regulatory requirements, which includes the general duty to effectively supervise and to ensure that appropriate action is taken when a concern is identified. Such action would depend on the circumstances of each case and may include following up with the registered salesperson and/or the client. Supervisory staff must also maintain records of the issues identified, action taken and resolution achieved.

I. ESTABLISHING AND MAINTAINING PROCEDURES

Effective self-regulation begins with the Member establishing and maintaining a supervisory environment which both fosters the business objectives of the Member and maintains the self-regulatory process. To that end a Member must establish and maintain procedures which are supervised by qualified individuals. A major aspect of self-regulation is the ongoing education of staff in all areas of sales compliance.

Establishing Procedures

1. Members must appoint designated individuals who have the necessary knowledge of industry regulations and Member policies to properly perform the duties.
2. Written policies must be established to document supervision requirements.
3. Written instructions must be supplied to all supervisors and alternates to advise them on what is expected of them.
4. All policies established or amended should have senior management approval.

Maintaining Procedures

1. Evidence of supervisory reviews must be maintained. Evidence of the review, such as inquiries made, replies received, date of completion etc. must be maintained for seven years and on-site for one year.
2. An on-going review of sales compliance procedures and practices must be undertaken both at head office and at branch offices.

Delegation of Procedures

1. Tasks and procedures may be delegated to a knowledgeable and qualified individual but not responsibility.
2. The Member must advise supervisors of those specific functions which cannot be delegated, such as approval of new accounts.
3. The supervisor delegating the task must ensure that these tasks are being performed adequately and that exceptions are brought to his/her attention.
4. Those who are delegated tasks must have the qualifications and required proficiency to perform the tasks and should be advised in writing of their duties. The general expectation is that tasks be delegated only to individuals with the same proficiency as the delegating supervisor. In certain limited circumstances, it may be acceptable to delegate specialized tasks to an individual that has not satisfied the proficiency requirements provided that the individual has equivalent training, education or experience related to the function being performed. The Member must consider the responsibilities and functions to be performed in relation to the delegated tasks and make a determination as to appropriate equivalent qualifications and proficiency. The Member must be able to demonstrate to MFDA staff that the equivalency standard has been met. Tasks related to trade supervision can only be delegated to individuals that possess the proficiency of a branch manager or compliance officer.

Education

1. The Member's current policies and procedures manual must be made available to all sales and supervisory staff.
2. Introductory training and continuing education should be provided for all registered salespersons. For training and enhanced supervisory requirements for newly registered salespersons, please refer to the MFDA Policy No. 1 entitled "New Registrant Training and Supervision Policy."
3. Relevant information contained in compliance-related MFDA Member Regulation Notices and Bulletins and compliance-related notices from other applicable regulatory bodies must be communicated to registered salespersons and employees. Procedures relating to the method and timing of distribution of compliance-related information must be clearly detailed in the Member's written procedures. Members should ensure that they maintain evidence of compliance with such procedures.

II. OPENING NEW ACCOUNTS

To comply with the KYC and suitability requirements set out in MFDA Rule 2, each Member must establish procedures to maintain accurate and complete information on each client. The first step towards compliance with this rule is completing proper documentation

when opening new accounts. Accurate completion of the documentation when opening a new account allows both the registered salesperson and the supervisory staff to conduct the necessary reviews to ensure that recommendations made for any account are appropriate for the client and in keeping with investment objectives. Maintaining accurate and current documentation will allow the registered salesperson and the supervisory staff to ensure that all recommendations made for any account are and continue to be appropriate for a client's investment objectives.

Documentation of Client Account Information

1. A New Account Application Form (“NAAF”) must be completed for each new account.
2. A complete set of documentation relating to each client’s account must be maintained by the Member. Registered salespersons must have access to information and documentation relating to the client’s account as required to service the account. In the case of a Level 1 Introducing Dealer and corresponding Carrying Dealer, both Members must maintain a copy of each client's NAAF.
3. For each account of a client that is a natural person, the Member must obtain information sufficient to allow for the operation of the account and sufficient to determine the essential facts relative to each client, which would include, at a minimum, the following information:
 - (a) name;
 - (b) type of account;
 - (c) residential address and contact information;
 - (d) date of birth;
 - (e) employment information;
 - (f) number of dependants;
 - (g) other persons with trading authorization on the account;
 - (h) other persons with a financial interest in the account;
 - (i) investment knowledge;
 - (j) risk tolerance;
 - (k) investment objectives;
 - (l) time horizon;
 - (m) income;
 - (n) net worth;
 - (o) for non-registered leveraged accounts, details of the net worth calculation, specifying liquid assets plus any other additional assets less total liabilities;
 - (p) information required by other laws and regulations applicable to the Member’s business as amended from time to time including information required for

relevant tax reporting; information required for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* and any authorization necessary to provide information to the MFDA under applicable privacy legislation.

The preceding provides a list of minimum requirements. The Member may require clients to provide any additional information that it considers relevant. In the case of accounts jointly owned by two or more persons, information required under subparagraphs (a), (c), (d), (e), (f) and (i) must be collected with respect to each owner. Income and net worth may be collected for each owner or on a combined basis as long as it is clear which method has been used.

4. For each account of a client that is a corporation, trust or other type of legal entity, the Member must obtain information sufficient to allow for the operation of the account and sufficient to determine the essential facts relative to the client, which would include, at a minimum, the following information:
 - (a) legal name;
 - (b) head office address and contact information;
 - (c) type of legal entity (i.e. corporation, trust, etc.);
 - (d) form and details regarding the organization of the legal entity (i.e. articles of incorporation, trust deed, or other constating documents);
 - (e) nature of business;
 - (f) persons authorized to provide instructions on the account and details of any restrictions on their authority;
 - (g) investment knowledge of the persons to provide instructions on the account;
 - (h) risk tolerance;
 - (i) investment objectives;
 - (j) time horizon;
 - (k) income;
 - (l) net worth;
 - (m) information required by other laws and regulations applicable to the Member's business as amended from time to time including information required for relevant tax reporting; information required for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* and any authorization necessary to provide information to the MFDA under applicable privacy legislation.

The preceding provides a list of minimum requirements. The Member may require clients to provide any additional information that it considers relevant.

5. For supervisory purposes, registered accounts, leveraged accounts and accounts of any registered salesperson's family member operating under a limited trading authorization or operating under a power of attorney in favour of the registered salesperson must be readily identifiable.

6. If the NAAF does not include KYC information, this must be documented on a separate KYC form(s). Such form(s) must be signed by the client and dated. A copy of the completed NAAF and KYC form, if separate from the NAAF, must be provided to the client.
7. The Member must have internal controls and policies and procedures in place with respect to the entry of KYC information on their back office systems. Such controls should provide an effective means to detect and prevent inconsistencies between the KYC information used for account supervision with that provided by the client.
8. Except as noted in the following paragraph, NAAFs must be prepared and completed for all new clients prior to the opening of new client accounts. The new account or KYC information must be approved by the individual designated as responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the initial transaction date. Records of all such approvals must be maintained in accordance with Rule 5.
9. Notwithstanding the preceding paragraph, NAAFs for clients of a registered salesperson 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). The new accounts or KYC information for clients of the transferring salesperson must be approved by the individual designated as responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the date that the NAAF is completed. Records of all such approvals must be maintained in accordance with Rule 5.
10. In the event that a NAAF is not completed prior to or within a reasonable time after opening an account, as required by this Policy, the Member must have policies and procedures to restrict transactions on such accounts to liquidating trades until a fully completed NAAF is received.

Changes to KYC Information

1. The registered salesperson or Member must update the KYC information whenever they become aware of a material change in client information as defined in Rule 2.2.4(a).
2. On account opening, the Member should advise the client to promptly notify the Member of any material changes in the client information, as defined in Rule 2.2.4(a), previously provided to the Member and provide examples of the types of information that should be regularly updated.
3. In accordance with Rule 2.2.4(e), Members must also, on an annual basis, request in writing that clients notify them if there has been any material change in client information, as defined in Rule 2.2.4(a), previously provided, or if the client's circumstances have materially changed.
4. Access to amend KYC information must be controlled and instructions to make any such amendments must be properly documented.

5. A client signature, which may include an electronic signature, or other internal controls sufficient to authenticate the client's identity and verify the client's authorization must be used to evidence any change in client name, client address or client banking information.
6. Material changes to client information, as defined in Rule 2.2.4(a), may be evidenced by a client signature, which may include an electronic signature or, alternatively, such changes may be evidenced by maintaining notes in the client file detailing the client's instructions to change the information and verified by providing written confirmation to the client with details of the instructions and providing an opportunity for the client to make corrections to any changes that have been made.
7. All material changes in client information, as defined in Rule 2.2.4(a), must be approved by the individual designated as responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the date on which notice of the change in information is received from the client. When approving material changes, branch managers should be reviewing the previous KYC information to assess whether the change appears reasonable. Branch managers should be aware of situations where material changes may have been made to justify unsuitable trades or leveraging. For example, branch managers should investigate further material changes that accompany trades in higher risk investments or leveraging or changes made within a short period of time (for example 6 months). Records of all such approvals must be maintained in accordance with Rule 5.
8. Where any material changes have been made to the information contained in the NAAF or KYC form(s), the client must promptly be provided with a document or documents specifying the current risk tolerance, investment objectives, time horizon, income and net worth that applies to the client's account.
9. The last date upon which the KYC information has been updated or confirmed by the client must be indicated in the client's file and on the Member's back office system.

Pending/Supporting Documents

1. Members must have procedures in place to ensure supporting documents are received within a reasonable period of time of opening the account.
2. Supporting documentation that is not received or is incomplete must be noted, filed in a pending documentation file and reviewed on a periodic basis.
3. Failure to obtain required documentation within 25 days of the opening of the account must result in positive actions being taken.

Client Communications

1. All hold mail must be authorized by the client in writing and be controlled, reviewed on a regular basis and maintained by the responsible supervisor. Hold mail should

- never be permitted to occur over a prolonged period of time (i.e. in excess of 6 months).
2. Returned mail is to be promptly investigated and controlled.

III. ASSESSING SUITABILITY OF INVESTMENTS AND BORROWING TO INVEST (“LEVERAGING”) STRATEGIES

General

1. Members must establish and maintain policies and procedures with respect to their suitability obligations. The policies and procedures must include guidance and criteria for registered salespersons to ensure that recommendations made and orders accepted (with the exception of unsolicited orders accepted pursuant to Rule 2.2.1(d)) are suitable for the client. The policies and procedures must also include criteria for supervisory staff at the branch and head office to review the suitability of the investments in each client’s account and the client’s use of borrowing to invest (“leverage”).
2. The criteria for selecting trades and leverage strategies for review, the inquiry and resolution process, supervisory documentation requirements and the escalation and disciplinary process must be documented and clearly communicated to all registered salespersons and all relevant employees. Registered salespersons must be advised of the criteria used in assessing suitability, actions the Member will take when a trade or leverage strategy has been flagged for review and appropriate options for resolution.

Leverage Suitability

1. The suitability of leverage must be assessed having regard to the client’s investment knowledge, risk tolerance, age, time horizon, income, net worth and investment objectives. Minimum criteria that require further supervisory review and investigation include the following:
 - (a) investment knowledge of low or poor (or similar categories);
 - (b) risk tolerance of less than medium (or similar categories);
 - (c) age of 60 and above;
 - (d) time horizon of less than 5 years;
 - (e) total leverage amount that exceeds 30% of the client’s total net worth; and
 - (f) total debt and lease payments that exceed 35% of the client’s gross income, not including income generated from leveraged investments. Total debt payments would include all loans of any kind whether or not obtained for purpose of investment. Total lease payments would include all significant ongoing lease

and rental payments such as automobile leases and rental payments on residential property.

2. The objective of the supervisory review is to assess the suitability of the leveraging strategy. The supervisory review and investigation of leverage suitability must be conducted in a fair and objective manner having regard only to the best interest of the client in accordance with Rule 2.1.4 and the general standard of conduct required by Rule 2.1.1. Where the leverage strategy is approved, the analysis and rationale must be documented.
3. With respect to a recommendation for a client to use a leveraging strategy, Members and registered salespersons may not obtain a waiver from the client to exempt the Member and the registered salesperson from their obligations to ensure the suitability of such a recommendation.

4. The Member must review and maintain documents to facilitate proper supervision. This would include:

- (a) Lending documents and details of lending arrangements – The Member or registered salesperson must either maintain copies of the lending documents or make sufficient inquiries to obtain details of the loan, including interest rate, terms for repayment, and the outstanding loan value. Where the Member or registered salesperson assists the client in completing the loan application, the Member must maintain copies of lending documents in the file, including copies of the loan application.

Where the client arranges their own financing, it may be difficult in some cases for the Member or registered salesperson to obtain details of the lending arrangement from the client. Where a client is unwilling to provide details of the lending arrangement, the Member and registered salesperson should advise the client that they cannot assess the suitability of the leverage strategy without additional information and maintain evidence of such advice.

- (b) NAAF and updates to KYC information – Supervisory staff must compare the client’s KYC information with all other information received in respect of the loan and follow up on any material inconsistencies, which may require obtaining additional supporting documentation from the client.
- (c) Details in support of income and net worth calculations required by sections 1(e) and 1(f) – This would include information on all existing debt payments, as well as the investment loan payments.
- (d) Trade documents, notes supporting client instructions or authorizations and notes supporting the rationale for recommending a leverage strategy to the client.

Registered Salespersons

1. All recommendations made and orders accepted by registered salespersons (with the exception of unsolicited orders accepted pursuant to Rule 2.2.1(d)) must be suitable

in accordance with Rule 2.2.1(c). Where the registered salesperson recommends a leverage strategy to a client or where the registered salesperson is aware that a transaction proposed by the client involves the use of borrowed funds, the registered salesperson must ensure that the client's account is identified as "leveraged" on the Member's system in accordance with the Member's policies and procedures.

2. Registered salespersons must assess the suitability of investments in each client account whenever:
 - the client transfers to the Member or transfers assets into an account at the Member;
 - the Member or registered salesperson becomes aware of a material change in the client's KYC information; or
 - the client account has been re-assigned to the registered salesperson from another registrant at the Member.

Where there is a transfer of assets into an account at the Member or where the client account is re-assigned to the registered salesperson from another registrant at the Member, the suitability assessment must be performed 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 that gives 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 the Member or registered salesperson becomes aware of a material change in the client's KYC information, the suitability assessment must be performed no later than one business day after the date on which the notice of change in information is received from the client.

3. Registered salespersons must also assess the suitability of a leverage strategy whenever:
 - the client transfers assets purchased using borrowed funds into an account at the Member;
 - the Member or registered salesperson becomes aware of a material change in the client's KYC information; or
 - the client account has been re-assigned to the registered salesperson from another registrant at the Member.

Where there is a transfer of assets purchased using borrowed funds into an account at the Member or where the client account is re-assigned to the registered salesperson from another registrant at the Member, the suitability assessment must be performed in a timely manner as soon as possible after the transfer in accordance within the circumstances, but in any event no later than the time of the next trade.

Where the Member or registered salesperson becomes aware of a material change in the client's KYC information, the suitability assessment must be performed no later than one business day after the date on which the notice of change in information is

received from the client.

4. Should a registered salesperson identify unsuitable investments in a client's account or an unsuitable leverage strategy, the registered salesperson must advise the client and take appropriate steps to determine if there has been any change to client circumstances that would warrant altering the KYC information. Where there has not been a change in client circumstances, it is inappropriate to alter the KYC information in order to match the investments in the client's account or the leverage strategy. If there is no change to the KYC information, or if investments in the account or the leverage strategy continue to be unsuitable after the KYC information has been amended, the registered salesperson should discuss any inconsistencies with the client and provide recommendations as to rebalancing investments in the account. Transactions in the account must only be made in accordance with client instructions and any recommendations made with respect to the rebalancing of the account must be properly recorded.

Where an existing leverage strategy is determined to be unsuitable, the client must be advised of his/her options.

5. Registered salespersons must maintain evidence of completion of all suitability assessments performed and any follow up action taken with respect to such assessments.

IV. BRANCH OFFICE SUPERVISION

Each branch manager must undertake certain activities within the branch for purposes of assessing compliance with the Member's policies and procedures and regulatory requirements. These activities should be designed to identify failures to adhere to required policies and procedures and provide a means of revealing and addressing undesirable account activity.

Daily Reviews

1. All new account applications and updates to client information must be reviewed and approved in accordance with this Policy.
2. The branch manager (or alternate) must review the previous day's trading for unsuitable trades and any other unusual trading activity using any convenient means. This review must include, at a minimum, all:
 - initial trades;
 - trades in exempt securities (excluding guaranteed investment certificates);
 - leveraged trades/leverage recommendations for accounts other than registered retirement savings plans or registered education savings plans;
 - trades in accounts of family members of registered salespersons operating under a power of attorney in favour of the registered salesperson;

- redemptions over \$10,000;
- trades over \$2,500 in moderate-high or high risk investments;
- trades over \$5,000 in moderate or medium risk investments; and
- trades over \$10,000 in all other investments.

For the purposes of this section, “trades” does not include redemptions except where specifically referenced.

3. When reviewing redemptions, branch managers should seek to identify and assess:
 - the suitability of the redemption with regard to the composition of the remaining portfolio;
 - the impact and appropriateness of any redemption charges;
 - possible outside business activity where money may be leaving the Member for reinvestment into other potentially inappropriate or unauthorized investments; and
 - potential churning, including situations where redemption proceeds are being held on a temporary basis pending reinvestment.
4. The branch manager (or alternate) is responsible for following up on unusual trades identified by head office.

Other Reviews

1. The branch manager must assess the suitability of investments in each client account and the suitability of the client’s use of leverage, if any, where the Member becomes aware of a material change in the client’s KYC information that results in a significant decrease in the client’s risk tolerance, time horizon, income or net worth or more conservative investment objectives. The suitability assessment must be performed no later than one business day after the date on which notice of the change in information is received from the client.
2. In addition to transactional activity, branch managers must also keep themselves informed as to other client-related compliance matters such as complaints.

V. HEAD OFFICE SUPERVISION

A two-tier structure is required to adequately supervise client account activity. While the head office or regional area level of supervision by its nature cannot be in the same depth as branch level supervision, it should cover the same elements. Head office review should be focused on unusual activity or reviews that cannot be carried out at the branch level. Head office reviews must include procedures to effectively detect unsuitable investments and excessive trading in client accounts.

Daily Reviews

1. In addition to the trading review criteria for branch managers, head office must conduct daily reviews of account activity which must include, at a minimum, all:
 - redemptions over \$50,000;
 - trades over \$5,000 in exempt securities (excluding guaranteed investment certificates), moderate-high or high risk investments, or leveraged trades/recommendations for accounts other than registered retirement savings plans or registered education savings plans;
 - trades over \$10,000 in moderate or medium risk mutual funds; and
 - trades over \$50,000 in all other investments (excluding money market funds).

For the purposes of this section, “trades” does not include redemptions except where specifically referenced.

2. There must be closer supervision of trading by registered salespersons who have had a history of questionable conduct. Questionable conduct may include trading activity that frequently raises questions in account reviews, frequent or serious complaints, regulatory investigations or failure to take remedial action on account problems identified.
3. Daily reviews should be completed within one business day unless precluded by unusual circumstances.
4. Daily reviews should be conducted of client accounts of producing branch managers.

Other Reviews

1. On a sample basis, the Member must review the suitability of investments in accounts where clients have transferred assets into an account in accordance with Rule 2.2.1(e)(i). The Member must have policies and procedures regarding sample size and selection, which should be based on the risk level associated with the account, focusing on accounts that hold higher risk investments, exempt securities or products not sold by the Member, accounts that are operated under a power of attorney in favour of a registered salesperson and accounts employing a leverage strategy other than registered retirement savings plans and registered education savings plans. The Member’s reviews must be completed within a reasonable time, but in any event no later than the time of the next trade.
2. Members must also review the suitability of the use of leverage in all cases where the client transfers assets purchased using borrowed funds into an account at the Member. Given the high risk nature of leveraging strategies, the Member’s reviews must be completed in a timely manner as soon as possible after the transfer in accordance with the circumstances, but in any event no later than the time of the next trade.

VI. IDENTIFICATION OF TRENDS IN TRADING ACTIVITY

1. Members must establish policies and procedures to identify trends or patterns that may be of concern including:
 - excessive trading or switching between funds indicating possible unauthorized trading, lack of suitability or possible issues of churning (for example, redemptions made within 3 months of a purchase, DSC purchases made within 3 months of a DSC redemption or accounts where there are more than 5 trades per month);
 - excessive switches between no load funds and deferred sales charge or front load funds;
 - excessive switches between deferred sales charge funds and front load funds; and
 - excessive switches where a switch fee is charged.
2. Head office supervisory review procedures must include, at a minimum, the following criteria:
 - a review of all accounts generating commissions greater than \$1,500 within the month;
 - a quarterly review of reports on assets under administration (“AUA”) comparing current AUA to AUA at the same time the prior year;
 - a quarterly review of commission reports for the previous 12 month period comparing commissions received in the current year to commissions received for the same period in the prior year.

Significant increases in commissions or AUA beyond those caused by market fluctuations may indicate issues with churning or leveraging strategies. Significant decreases may indicate potential inappropriate outside business activity.

3. Reviews should be completed within 30 days of the last day of the period being reviewed unless precluded by unusual circumstances.