

# MUTUAL FUND DEALERS ASSOCIATION OF CANADA

## PROPOSED AMENDMENTS TO MFDA BY-LAW NO. 1 (DEFINITIONS) MFDA RULE 2.5.5 (BRANCH MANAGER) AND MFDA POLICY NO. 2 *MINIMUM STANDARDS FOR ACCOUNT SUPERVISION*

### I. OVERVIEW

#### A. Current Framework

MFDA Rule 2.5.5 (Branch Manager) requires Members to designate an individual qualified as a branch manager under the Rule for each branch office, as defined in MFDA By-law No. 1. The Member is not required to designate an on-site branch manager for sub-branches, provided that an off-site branch manager supervises the business at the sub-branch in accordance with the MFDA By-laws, Rules and Policies. “Branch office” is defined in By-law No. 1 as any office or location from which any dealer business of a Member is conducted. “Sub-branch” is defined as any branch office having in total less than four Approved Persons and supervised by an off-site branch manager.

MFDA Policy No. 2 *Minimum Standards for Account Supervision* requires the branch manager to undertake certain activities within the branch for the purpose of assessing compliance with the Member’s policies and procedures and regulatory requirements.

#### B. Reasons for Amendments

In 2001, when the MFDA was in the process of being established, there were inconsistent requirements with respect to branch supervision across Canada. Securities regulation in certain provinces required an on-site branch manager if the branch employed a certain number of registered individuals. The requirement under MFDA Rule 2.5.5 and By-law No. 1 to designate a branch manager for branch locations with four or more Approved Persons adopted the highest standard that existed at the time under Canadian securities regulation. In the view of MFDA staff, this requirement was appropriate at the time, given that many mutual fund dealers were not accustomed to having to adhere to a structured compliance regime. However, since that time, staff has observed improvements in Member supervisory systems and processes and, in particular, systems used to supervise trades.

MFDA Members have also recommended that the MFDA consider a more flexible, principle-based approach to branch supervision that is consistent with the approach adopted under the Rules of the Investment Industry Regulatory Organization of Canada (“IIROC”) and by the Canadian Securities Administrators (“CSA”) under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”).

## **C. Objectives**

The proposed amendments are intended to provide Members with a more flexible, principle-based approach in determining how to best supervise their branches, while still ensuring that there are appropriate structures and procedures in place to identify and manage potential compliance issues at the branch level.

## **D. Effect of Proposed Amendments**

The proposed amendments will allow Members to develop compliance and supervisory structures that are appropriate for individual types of businesses, while continuing to ensure that there are adequate structures and procedures in place to identify and manage potential compliance issues at the branch level.

## **II. DETAILED ANALYSIS**

### **A. Proposed Amendments**

Below is a summary of the proposed amendments to Rule 2.5.5, Policy No. 2 and By-law No. 1. The blacklined versions of the Rule, Policy and By-law reflecting the proposed amendments are attached as Schedule “A” to this Notice.

#### MFDA Rule 2.5.5 (Branch Manager)

The proposed amendment to Rule 2.5.5(b) would require that individuals designated as branch managers submit to the jurisdiction of the MFDA. This amendment is necessary because of changes to the securities registration regime brought about through NI 31-103, which no longer requires the registration of branch managers. As some branch managers may not be registered in another capacity (i.e. as a salesperson), this proposed amendment is required to ensure that the MFDA maintains jurisdiction over these individuals.

Proposed Rule 2.5.5(c) states that a Member may designate a branch manager for a branch office who is not normally present at the office, provided the Member has a system to ensure effective supervision of activities at the branch. Given the risk of impact to investors where inadequate supervision is conducted, it is proposed that Members obtain the approval of MFDA staff before implementing a system involving the remote supervision of branches. Staff would review the Member’s overall branch supervisory structure to ensure effective supervision of branches and sub-branches. The factors considered in determining whether to approve a branch supervisory structure involving remote supervision are set out in the proposed amendments to Policy No. 2. Staff would review the Member’s branch supervisory structure as part of the compliance examination process.

The proposed amendments to Rule 2.5.5(c) and Policy No. 2 are principle-based and do not prescribe specific criteria that must be met to implement a system of remote supervision. Once staff has had the opportunity to review requests for remote supervision, a guidance Notice will be issued to Members setting out examples of the types of branch supervision structures that have been approved by staff in accordance with Rule 2.5.5(c).

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

Proposed amendments to Policy No. 2 set out factors to be considered in determining whether an on-site branch manager is necessary at a branch. The proposed amendments also provide that, where a branch does not have an on-site branch manager, the Member must assign an off-site branch manager to the branch. The Member's policies and procedures and the instructions to the off-site branch manager must include provision for periodic visits to the location by the branch manager, as necessary, to ensure that business is being conducted properly at the location. These visits would be independent from the branch reviews required under MFDA Policy No. 5 *Branch Review Requirements*. The proposed amendments to Policy No. 2 also require Members to maintain an internal record of branch managers and the branches and sub-branches they are responsible for supervising.

## MFDA By-law No. 1 – Definition of “Approved Person”

Amendments to the definition of “Approved Person” in By-law No. 1 have been proposed to clarify that in order to be subject to the jurisdiction of the MFDA as an Approved Person, an individual must either be registered or permitted under securities law or submit to the jurisdiction of the MFDA.

The current definition of Approved Person does not refer to permitted individuals, who are defined under National Instrument 33-109 *Registration Information* as: (a) a director, chief executive officer, chief financial officer, or chief operating officer of a firm, or an individual who performs the functional equivalent of any of those positions, or (b) an individual who has beneficial ownership of, or direct or indirect control or direction over 10 percent or more of the voting securities of a firm. The proposed amendment is intended to clarify that Approved Persons include permitted individuals as defined under securities law.

### **B. Issues and Alternatives Considered**

The proposed amendments maintain the branch manager designation and the terms “branch” and “sub-branch”. MFDA staff considered replacing the branch manager designation with the designation of “Supervisor”. However, the Supervisor designation under IIROC Rules is broad in scope and applies beyond the branch supervision context, as it includes not only individuals performing branch manager functions, but also other individuals performing supervisory functions that are not applicable in the mutual fund dealer context. Supervisory functions and responsibilities of branch managers are well established under MFDA Rules and understood by Members. The proposed amendments, while different in form from the IIROC Rules, achieve the same regulatory objective of allowing flexibility with respect to branch supervision.

### **C. Comparison with Similar Provisions**

As noted, the proposed amendments are consistent with and meet the same regulatory objectives as the approach to branch supervision contemplated under the IIROC Rules and by the CSA under NI 31-103.

### NI 31-103

Under section 11.1 of NI 31-103, registered firms must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to: (i) provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation; and (ii) manage the risks associated with its business in accordance with prudent business practices.

The Companion Policy to the Instrument notes that monitoring and supervision are essential elements of a firm's compliance system, indicating that such functions include day-to-day monitoring and supervision and overall systemic monitoring. In addition, the Companion Policy notes that it is up to each registered firm to determine the most appropriate compliance system for its operations and that registered firms should consider the size and scope of their operations, including products, types of clients, risks, compensating controls and any other relevant factors.

### IIROC

IIROC Rule 38.3 requires that individuals designated as Supervisors be approved by IIROC. IIROC staff reviews requests for remote supervision when approving a supervisor or location for registration. As noted above, given the risk of impact to investors where inadequate supervision is conducted, it is proposed that Members obtain the approval of MFDA staff before implementing a system involving the remote supervision of branches.

In determining whether an on-site branch manager is necessary at a branch, the proposed amendments to Policy No. 2 take into consideration factors including: the number and experience of Approved Persons at the branch; the nature of the business conducted at the branch; and the availability of a branch manager or branch managers at nearby locations. These considerations are consistent with those set out under IIROC Rule 2500 *Minimum Standards for Retail Customer Account Supervision* in respect of factors that an IIROC Dealer member should consider when determining to what extent a Resident Supervisor is necessary at a business location.

In addition, where a branch or sub-branch does not have an on-site branch manager, the proposed amendments to Policy No. 2 require the Member to assign an off-site branch manager to the location and that the Member's policies and procedures and instructions to the off-site branch manager provide for periodic visits by the branch manager to ensure that business is being conducted properly at the location. These requirements are also consistent with those imposed under IIROC Rule 2500.

#### **D. Systems Impact of Amendments**

The proposed amendments offer Members flexibility in determining how to best supervise their branches. However, they do not require that Members make any changes to their existing compliance or branch supervisory structures/practices. As a result, it is not anticipated that the proposed amendments will have a significant impact upon Members' systems.

The proposed amendments do not impose any burden or constraint on competition or innovation or impose costs or restrictions on the activities of market participants. It is not expected that there will be any significant increased costs of compliance as a result of the proposed amendments.

#### **E. Best Interests of the Capital Markets**

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

#### **F. Public Interest Objective**

The proposed amendments are consistent with the public interest and would continue to ensure adequate supervision at the branch and sub-branch levels while allowing Members the flexibility to adopt supervisory structures that are more aligned with their respective business models.

#### **G. Classification**

Having regard to the substantive nature of the proposed amendments, they have been classified as Public Comment Rule proposals.

### **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 and Consumer Affairs Authority.

#### **B. Effectiveness**

The proposed amendments are simple and effective.

#### **C. Process**

The proposed amendments have been developed in consultation with the MFDA Policy Advisory Committee (“PAC”) and relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on November 28, 2012. In approving the proposed amendments, the MFDA has followed its established internal governance practices and has considered the need for consequential amendments.

**D. Effective Date**

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

**E. Exemption from Requirements under Securities Legislation**

The proposed amendments do not involve a Rule that the MFDA, its Members or Approved Persons must comply with in order to be exempted from a securities legislation requirement.

**F. Conflict with Applicable Laws or Terms and Conditions of Recognition Order**

The proposed amendments do not conflict with applicable laws or the Terms and Conditions of a Recognizing Regulator’s Recognition Order.

**IV. SOURCES**

- MFDA By-law No. 1
- MFDA Rule 2.5.5 (Branch Manager)
- MFDA Policy No. 2 *Minimum Standards for Account Supervision*
- IIROC Rule 1.1 *Interpretation and Effect*
- IIROC Rule 38 *Compliance and Supervision*
- IIROC Rule 2500 *Minimum Standards for Retail Customer Account Supervision*
- IIROC Rule 2900 *Proficiency and Education*
- National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

**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:

Paige Ward  
General Counsel and Vice-President, Policy

Mutual Fund Dealers Association of Canada  
121 King St. West, Suite 1000  
Toronto, Ontario  
M5H 3T9  
[pward@mfd.ca](mailto:pward@mfd.ca)

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  
[ahamilton@bcsc.bc.ca](mailto:ahamilton@bcsc.bc.ca)

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](http://www.mfda.ca).

Questions may be referred to:

Paige Ward  
General Counsel and Vice-President, Policy  
Mutual Fund Dealers Association of Canada  
(416) 943-5838

DM#318986

## Schedule “A”

### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

On November 28, 2012, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to the MFDA By-law No. 1, Rule 2.5.5 (Branch Manager) and Policy No. 2 *Minimum Standards for Account Supervision*:

#### Proposed Amendments to MFDA By-Law No. 1 – Definitions

“Approved Person” means, ~~in respect of a Member,~~ an individual who is a partner, director, officer, branch manager, or alternate branch manager, employee or agent of the Member ~~who conducts or participates in the dealer business of the Member and~~ who (i) is registered, ~~or permitted, licensed or approved in the appropriate category~~ where required by applicable securities legislation, by the securities commission having jurisdiction, ~~and (ii) is designated and qualified as such in accordance with the Rules,~~ or (iii) ~~is otherwise subject~~ submits to the jurisdiction of the Corporation.

#### Proposed Amendments to MFDA Rule 2.5.5

##### 2.5.5 Branch Manager

- (a) **Designation.** Each Member must designate an individual qualified as a branch manager pursuant to paragraph (b) for each branch office (as defined in By-law 1.1) of the Member. The Member is not required to designate a branch manager for a sub-branch office who is normally present at the office, provided that a branch manager who is not normally present at such sub-branch office, ~~or a trading partner, director or officer or a compliance officer designated as the branch manager for such sub-branch office,~~ supervises its business at the sub-branch office in accordance with the By-laws, ~~and~~ Rules and Policies.
- ~~(b) Each individual designated as branch manager or alternate branch manager must submit to the jurisdiction of the MFDA.~~
- ~~(c) Notwithstanding paragraph (a), and subject to the approval of the Corporation, a Member may designate branch managers for branch offices who are not normally present at the offices provided the Member has a system to ensure effective supervision of activities at the branches.~~
- (b) **Proficiency Requirements.** An individual may not be designated by the Member as a branch manager pursuant to paragraph (a) or an alternate branch manager pursuant to paragraph (e) unless the individual has:
- (i) met the requirements for a salesperson as prescribed under applicable securities legislation and has passed any one of the following examinations:



- (A) the Branch Managers Course Exam offered by the CSI Global Education Inc.;
- (B) the Mutual Fund Branch Managers' Examination Course Exam offered by the IFSE Institute; or
- (C) the Branch Compliance Officers Course Exam offered by the CSI Global Education Inc.

(~~ee~~) **Experience Requirements.** In addition to the requirements set out in ~~paragraph (d)~~ Rule 2.5.5(b), each branch manager, except alternate branch managers, in respect of a Member shall:

- (i) have acted as a salesperson, trading partner, director, officer or compliance officer registered under the applicable securities legislation for a minimum of two years; or
- (ii) have a minimum of two years of equivalent experience to that of an individual described in paragraph (i).

(~~fe~~) **Responsibilities.** The branch manager must:

- (i) supervise the activities of the Member at a branch or sub-branch that are directed towards ensuring compliance with the By-laws, Rules and Policies and with applicable securities legislation by the Member and its Approved Persons; and
- (ii) supervise the opening of new accounts and trading activity at the branch office.

(~~ge~~) **Alternates.** In the event that a branch manager is temporarily absent or unable to perform his or her responsibilities, a Member shall designate one or more alternate branch managers who must be qualified as branch managers pursuant to paragraph (~~bd~~) and who shall carry out the responsibilities of the branch manager, but are not required to be normally present at the branch office.

## **Proposed Amendments to MFDA Policy No. 2**

### **MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

#### **MFDA POLICY NO. 2**

##### ***MINIMUM STANDARDS FOR ACCOUNT SUPERVISION***

### **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 rule and suitability of investment requirements is primarily the responsibility of the registered salesperson. The supervisory standards in this Policy relating to know-your-client 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.

### **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 personnel.
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 "Know-Your-Client" 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. Approved Persons 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, NAAF's 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, NAAF's 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 Know-Your-Client Information**

1. The Approved Person 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 LEVERAGING STRATEGIES**

1. In accordance with Rule 2.2.1, Members and registered salespersons are responsible for the suitability of each recommendation made for an account of a client and must assess the suitability of the investments in each client's account under the circumstances described in Rule 2.2.1(e).
2. Members must have policies and procedures with respect to their suitability obligations, including criteria for the purpose of assessing the suitability of a client's use of leveraging and describing appropriate client circumstances for recommending the use of leverage.
3. The Member's policies and procedures must describe the information required to be maintained in the client file to facilitate proper Member supervision. Whenever the Member or registered salesperson recommends or becomes aware that a client is using a leverage strategy, the Member or registered salesperson must either maintain copies of the lending documents or make sufficient inquiries to obtain details of the loan, 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.

4. The Member's criteria for selecting trades 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 the Member uses in assessing suitability, actions the Member will take when a trade has been flagged for review and appropriate options for resolution.
5. Registered salespersons must 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, 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; and
  - the client account has been re-assigned to the registered salesperson from another registrant at the Member.

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.

6. Should a registered salesperson identify unsuitable investments in a client's account, 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. It is inappropriate to alter the KYC information in order to match the investments in the client's account. If there is no change to the KYC information, or if investments in the account 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.
7. 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.~~

1. An on-site branch manager is in the best position to know the registered salespersons in the office, know or meet many of the clients, understand local conditions and needs, facilitate business through the timely approval of new accounts and respond immediately to questions or problems. In accordance with Rule 2.5.5(c), a Member may designate a branch manager for a branch office who is not normally on-site. In determining whether an on-site branch manager is necessary at a branch, the following factors should be considered:
  - the specific activities at the branch;
  - complaint history;
  - number of Approved Persons at the branch;
  - experience of Approved Persons at the branch;
  - trade volume/commissions earned;
  - results of previous Policy No. 5 branch reviews;
  - MFDA compliance examination findings;
  - daily trade supervision issues;
  - supervisory tools used at the branch (manual or automated);
  - the nature of dual occupations or outside business activities carried on at the branch; and
  - the availability of a branch manager or branch managers in nearby locations.
2. Where a branch or sub-branch does not have an on-site branch manager, the Member must assign an off-site branch manager to the location. The Member's policies and procedures and the instructions to the off-site branch manager must include provision for periodic visits to the branch and sub-branch by the branch manager as necessary to ensure that business is being conducted properly at the location. These visits would be independent from the branch reviews required under MFDA Policy No. 5. Members must maintain records of the visits as well as issues identified and follow-up action taken.
3. Members must maintain an internal record of branch managers and the branches and sub-branches they are responsible for supervising.

### Daily Activity

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 open accounts;
  - 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.
5. The branch manager must assess the suitability of investments in each client account 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.
6. 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 open accounts;
  - 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.
5. On a sample basis, the Member must review the suitability of investments in accounts where clients have transferred assets into an account. 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. The Member’s reviews must be completed within a reasonable time.

## **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.