Summary of Public Comments Respecting Proposed Amendments to MFDA Rule 2.2 (Client Accounts), Policy No. 2 *Minimum Standards for Account Supervision,* Rule 2.8 (Client Communications) and Rule 5.3 (Client Accounts) and Responses of the MFDA

On April 24, 2009, the British Columbia Securities Commission and Ontario Securities Commission published proposed amendments to MFDA Rule 2.2 (Client Accounts), Policy No. 2 *Minimum Standards for Account Supervision,* Rule 2.8 (Client Communications) and Rule 5.3 (Client Accounts) (the "**Proposed Amendments**") for a second 90-day public comment period. A further correction to the Proposed Amendments was published on May 8, 2009.

The public comment period expired on July 23, 2009.

10 submissions were received during the public comment period:

1. Advocis
2. Canadian Foundation for Advancement of Investor Rights – FAIR Canada ("FAIR")
3. IGM Financial Inc. ("IGM")
4. Independent Financial Brokers of Canada ("IFB")
5. Investment Funds Institute of Canada ("IFIC")
6. Primerica Financial Services (Canada) Ltd. ("PFSL")
7. Quadrus Investment Services Ltd. ("Quadrus")
8. Royal Mutual Funds Inc. ("RMFI") and Phillips, Hager & North Investment Funds Ltd. ("PH&N")
9. Scotia Securities Inc. ("SSI")
10. TD Investment Services Inc. ("TDIS")

Copies of comment submissions may be viewed at the offices of the MFDA, 121 King Street West, Suite 1000, Toronto, Ontario by contacting Ken Woodard, Director, Communications and Membership Services, (416) 943-4602.

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

Scope of the Client Relationship Model Proposals

FAIR expressed support for the Proposed Amendments and the Investment Industry Regulatory Organization of Canada ("IIROC") proposal as steps representing incremental improvements in the Client Relationship Model ("CRM"); however, FAIR expressed the view that the proposals do not go far enough towards the necessary complete overhaul of the relationship between the client and the advisor and recommended that the Canadian Securities Administrators ("CSA"), IIROC and the MFDA undertake a review of regulatory initiatives around the globe to ensure that Canadian investor protection keeps up with international best practices.

MFDA Response

The MFDA, through ongoing communication with investors and stakeholders and its regulatory oversight of Member operations, tests MFDA Rules both with respect to Member and Approved Person compliance with Rule requirements and the ongoing effectiveness of the Rules in meeting their regulatory objectives. The Proposed Amendments, once implemented, will be similarly subject to such a process of ongoing review and will be subject to amendments where warranted.

Principles-Based Approach

RMFI and PH&N expressed support for principles-based regulations, as they permit Members the flexibility necessary to efficiently apply regulations in consideration of their different business structures, address specific risks and allow securities regulators to respond more effectively to emerging issues without needing to introduce new or amend existing detailed rules every time a regulatory concern arises. RMFI and PH&N expressed the view that this is especially important in the current and expected future environment where there are continuous industry developments.

RMFI and PH&N expressed disappointment that certain areas identified during the first comment period as those that would be best addressed as regulatory guidance to Members, rather than as prescriptive requirements, remained prescribed in the Policy.

The IFB expressed agreement with the general principle that it is valuable for clients to have a clear definition of the relationship between themselves and the financial services provider, and that this definition should include a description of the roles and responsibilities that each party will assume when an investment account is opened. However, the IFB expressed the view that the number of new rules, processes, supervisory requirements and restrictions that will be required to implement this otherwise meaningful undertaking is excessive. The IFB recommended taking a less prescriptive approach to issues addressed by the Proposed Amendments.

MFDA Response

The Proposed Amendments seek to adopt a principles-based approach where this is appropriate. For example, Rule 2.2.5 sets out principles-based requirements for disclosure. In addition, even where the Proposed Amendments introduce prescriptive requirements, such as in Policy No. 2, MFDA staff remains open to considering alternate approaches to meeting such requirements where it can be demonstrated that such approaches meet the minimum standards set out in the Policy.

Where MFDA has prescribed requirements in greater detail, for example with respect to the trade review thresholds proposed in Policy No. 2, this has been in response to issues identified through MFDA compliance and enforcement activity. Suitability is one of the most common deficiencies identified during compliance examinations and is the most common complaint received by the MFDA from investors. The MFDA's regulatory *experience to date has demonstrated that the current principle-based approach to trade supervision has not been effective in addressing these ongoing concerns.*

The Proposed Amendments are also intended to respond to requests from Members for more direction and establish transparent and objective minimum standards for the industry and a consistent level of investor protection.

Cost/Benefit Analysis

The IFB reiterated its comment from the first consultation, stating that the Proposed Amendments will substantially increase the regulatory reporting and compliance activities of Approved Persons and Members and requested clarification of the justification of these new procedures and the related subsequent compliance costs relative to the number of serious complaints the MFDA receives, noting that such costs will undoubtedly be passed along to the investing public. The IFB, citing the MFDA's enforcement statistics, expressed the view that the statistical occurrence of complaints related to suitability supports the notion that the mutual fund industry is sufficiently regulated, as the incidence of improper behaviour is low. As a consequence, the IFB expressed the view that the increased reliance on prescriptive rules to address suitability is unnecessary.

While acknowledging that it is primarily concerned about the potential effects of the Proposed Amendments on Approved Persons and their clients, the IFB also expressed concern about the growing cost and burden of compliance that may ultimately negatively affect particularly smaller retail clients who will pay the price in reduced availability and accessibility of advice related to mutual funds, if dealers and/or advisors are forced to mandate minimum account requirements in order to justify the cost of providing such services.

MFDA Response

Suitability is the most common area of client complaints to the MFDA and to Members. The fact that the actual number of complaints escalated to litigation is low does not mean that risk of harm to clients is low. It is generally understood by regulators and industry participants that client complaint numbers are often indicative of a larger, more widespread level of concerns. The primary importance of complaint statistics is to show relative areas of complaints for the purpose of identifying the most important areas of concern. Accordingly, complaint statistics support the regulatory need for enhanced suitability requirements.

Complaints are also a lagging indicator of potential regulatory concerns. Addressing issues in response to complaints is reactive, after investor harm has occurred. MFDA also performs compliance examinations to monitor Member adherence to MFDA requirements to proactively ensure that Members and Approved Persons are complying with their obligations to clients, including their suitability obligation. Suitability concerns have been identified in almost all compliance examinations performed by the MFDA in its second examination cycle and inappropriate trade and account supervision *is the most common issue referred from the MFDA Compliance Department to the MFDA Enforcement Department for further investigation and potential discipline.*

Investment suitability has also been identified as a regulatory priority by the CSA who have recently undertaken their own initiatives in this area. MFDA staff does not believe the Proposed Amendments go beyond the measures necessary to ensure that the regulatory concerns identified have been addressed.

MFDA staff has developed the Proposed Amendments over the past three years based on numerous consultations with the industry through Member Regulation Forums, the MFDA Policy Advisory Committee ("PAC") and other ad hoc industry meetings and practical, first-hand experience gained by MFDA staff during their compliance and enforcement activities. MFDA Members were also consulted by way of industry subcommittees which were established in 2006 and presented with the original draft of the amendments for comment. In the course of these consultations, many suggestions were brought forward and discussed. Alternative viewpoints and suggestions from Members, regulators and other industry participants were also discussed at length in these consultations and input received was factored into the Proposed Amendments. The possibility of conducting a cost/benefit analysis of changes proposed in relation to the CRM project was considered and attempted by the CSA, SROs and the industry. Several meetings with the industry were held to discuss and agree upon the cost versus benefits survey approach to be pursued. However, no agreement with potential participants was reached regarding the approach to be followed in conducting the analysis.

Harmonization with Parallel Initiatives

The IFB recommended that the MFDA, CSA and IIROC harmonize their efforts as much as possible, so that the information provided to clients and the associated procedures for financial advisors and dealers are as streamlined and consistent as possible, regardless of their registration category. For example, the IFB recommended providing an exemption or reduced suitability obligations for investors who are "permitted clients" or have set up order execution only accounts, as is the case for the CSA and IIROC proposals.

IGM expressed the view that the Proposed Amendments are more prescriptive than the IIROC proposal and, recognizing that there has been improvement in this area since the previous publications of both the MFDA and IIROC proposals, recommended further harmonization.

MFDA Response

Suitability exemptions for certain clients and "order execution only accounts" for IIROC Members existed prior to the establishment of National Instrument 31-103 Registration Requirements and Exemptions ("NI 31-103"). Corresponding MFDA Rule amendments have not been developed to date as it does not appear Members require such relief. However, if circumstances change, policy amendments will be considered at that time.

The Proposed Amendments were subject to working group discussions between MFDA, IIROC and CSA staff aimed at ensuring that the proposals of the two self-regulatory organizations ("SRO") met the same regulatory objectives and minimized differences. The Proposed Amendments were also reviewed to ensure that they met the regulatory objectives under consideration for NI 31-103, as proposed at the time. Additional revisions were made to the Proposed Amendments as a result of such discussions. The Proposed Amendments of the two SROs, while structured differently in certain areas so as to accommodate the existing structure of the respective Rules, meet the same regulatory objectives. The more prescriptive requirements proposed by the MFDA, which have not as yet been adopted by IIROC, primarily relate to MFDA Policy No. 2 and, more specifically, to trade and account supervision. As noted above, MFDA has identified regulatory concerns in this area as a result of its regulatory activities and believes more prescriptive requirements in these areas are necessary to meet its investor protection mandate.

Changes Made in Response to the First Comment Period

The IFB noted that the Proposed Amendments, as published for the second comment period, do not adequately reflect the comments received during the first comment period, as only a few changes, primarily of technical nature, were made.

MFDA Response

All comments received were reviewed and considered. Comments suggesting additional revisions to the Proposed Amendments were incorporated where such suggestions were consistent with meeting the MFDA's investor protection mandate.

Transition Periods

SSI noted that the MFDA has recognized that systems changes will be required to implement the Proposed Amendments and recommended a 24-month transition period to comply with the new requirements before they become effective.

TDIS noted that the changes proposed in Policy No. 2 will require most Members to develop numerous system enhancements and recommended a 12-month transition period to develop appropriate systems and policies and procedures. Particularly, the addition of new fields to Member's systems to accommodate the new specific pieces of Know-Your-Client ("KYC") mandated by the Policy will be costly and time consuming requiring both front-end screen and back-end database changes and revision or redesign of new account application forms and/or KYC forms and any supporting system print capability. TDIS recommended a six-month transition period with respect to the requirement to provide the client with a document describing the client's risk tolerance, investment objectives, time horizon, income and net worth upon a material change to KYC information.

TDIS noted that Members relying on a third party to provide client name statements are dependent on those parties to make the changes required to provide performance reporting under Rule 5.3. In light of the fact that the proposed changes involve calculation of the information prior to presentation on the statement, they will require complex technology changes and systems will have to be rigorously tested. TDIS recommended a 24-month transition period to ensure that information provided is accurate and the presentation format is clear and easy to understand for clients. TDIS recommended that the transition period for the relationship disclosure requirement not commence until the later of the final approval of the Rule or the finalization of the Member Regulation Notice ("MR Notice"). TDIS recommended a period of six months to draft, review and produce a new relationship disclosure document.

IGM recommended an 18-month transition period for new account documentation requirements under proposed Rule 2.2.5; 24-month transition period for account revision requirements, suitability assessments, trade supervision requirements and trade review thresholds under Policy No. 2; and 36-month transition period for proposed performance reporting requirements under Rule 5.3.

IFIC expressed the view that the investment funds industry requires a suitable transition period for designing the required systems and testing, optimization, software implementation and training. Noting that IIROC allows a three-year transition period to adopt its provisions regarding providing the Relationship Disclosure Document to existing clients, IFIC recommended adopting an equally appropriate transition period to address the implementation issues.

MFDA Response

The MFDA has noted the comments made and will be harmonizing implementation periods with IIROC and with similar transition periods required by the CSA under NI 31-103.

Carrying Dealers

IGM recommended that the Proposed Amendments specifically address the division of responsibility between introducing and carrying dealers and specifically state, as contemplated by Rule 1.1.6(xi), that these requirements apply only to introducing dealers and not the carrying dealer except: (i) in the case of a Level 1 introducing dealer; or (ii) where the carrying dealer has agreed to perform specific compliance functions, only with respect to those specific compliance functions.

MFDA Response

Under MFDA Rule 1.1.6(b)(xii) for Level 1 introducing arrangements, the introducing dealer and carrying dealer are jointly and severally responsible for compliance with MFDA By-laws and Rules for each account introduced to the carrying dealer by the introducing dealer. In all other cases, the introducing dealer is responsible for such compliance, subject to the carrying dealer also being responsible for compliance with respect to those functions it agrees to perform under any arrangement entered into under Rule 1.1.6.

The responsibilities of Members entering into introducing/carrying arrangements, including those in respect of compliance as noted above, are clearly and specifically addressed under Rule 1.1.6.

Rule 2.2 (Client Accounts)

Rule 2.2.1 *Know-Your-Client*

Quadrus requested clarification whether the reference to "essential facts" in proposed Rule 2.2.1(c) encompasses review requirements in addition to those set out in MFDA MR-0069 *Suitability Guidelines*.

PFSL and IFIC recommended that, absent a change in KYC information, the requirement to perform a suitability review upon a change in the assigned Approved Person under Rule 2.2.1(e)(iii) be removed, as a change in representative does not cause accounts to become unsuitable. PFSL expressed the view that this requirement would duplicate the last suitability review that was conducted, although the commenter agreed that a newly assigned Approved Person should still be required to familiarize him/herself with the file as contemplated by current Policy No. 2 and perform a suitability review if he or she becomes aware of a material change in client circumstances.

IFIC noted that other requirements, such as the provision requiring a new representative to familiarize him/herself with the file and the suitability review requirement under Rule 2.2.1(c), as well as two-tier account supervision at the time of initial set up and subsequent triggers, are sufficient to render the requirement under proposed Rule 2.2.1(e)(iii) superfluous, particularly in light of limited investor benefit. IFIC expressed the view that the imposition of an "all-account" suitability review requirement on reassignments will cause a large number of additional suitability assessments to occur each year, with virtually all resulting in "suitable" conclusions and recommended, in case the MFDA is unwilling to remove this requirement completely, that a dollar threshold, such as $50,000 in assets, be adopted.

IFIC recommended allowing adequate time for conducting the review, particularly upon a transfer of assets into an account at the Member and suggested adding the following wording to the end of Rule 2.2.1(e): "prior to the first transaction after the change or client initiated activity with allowance for automated transactions to continue."

MFDA Response

The requirement for the Member and Approved Person to use due diligence to "learn the essential facts" is a general statement of the principles-based obligation to collect the facts necessary to know the client and assess suitability. Such facts will include, but may not necessarily be limited to, the enumerated items set out in MR-0069 or Policy No. 2, as such information represents the minimum necessary to operate the account and know the client. Depending on the circumstances, the Member or Approved Person may need *to collect other information to fully understand the client's investment needs and objectives.*

Under current Policy No. 2, Approved Persons are already required to review the client's KYC information where they have been assigned responsibility for a client's account. At the same time, they should also be reviewing the investments in the client's account to further understand the client's circumstances and assess suitability. We do not expect all accounts to be subject to a suitability review but rather only a sample selected on a risk basis. A $50,000 threshold would not, in itself, be an appropriate criterion. Automatic plans may or may not be included in the sample depending upon whether they meet the Member's risk criteria.

We agree with the commenter that Approved Persons, particularly those who earn commissions immediately on reassignment of the account, are expected to familiarize themselves with the client files in order to understand their new clients better. Rule 2.2.1 (e) (iii) does not impose an "all-account" suitability review on reassignment. As with the other suitability triggers, it would be expected that the suitability assessment on reassignment would be done on a sample basis using appropriate criteria developed by the Member (for example, accounts holding high risk investments, leveraged accounts, etc).

With respect to allowing adequate time to conduct a review and the suggested amendment to Rule 2.2.1(e), we note that Policy No. 2 requires the Approved Person to assess the suitability of investments in each client account within a reasonable time, but in any event no later than the time of the next trade. The determination of reasonable time in a particular instance will depend on the circumstances surrounding the event giving rise to the requirement to perform the suitability assessment.

Rule 2.2.2 *New Accounts*

IGM recommended clarifying proposed Rule 2.2.2(a) to provide that the obligation to open an account within a reasonable time is triggered only when the required documents are in good order.

MFDA Response

The obligation to open an account within a reasonable time arises when the required documents (i.e. all documents/information necessary to complete the account application) are received in good order. If a Member does not have sufficient information to open an account, it would not be expected to do so.

Rule 2.2.5 *Relationship Disclosure*

SSI expressed concern that proposed Rule 2.2.5, as drafted, is open to significantly different interpretations. SSI acknowledged the MFDA intent to issue a MR Notice to provide additional guidance with respect to the level of detail to be set out in the relationship disclosure document, but expressed the view, which was also echoed by

IFIC, that it is not possible to fully respond to the Proposed Amendments without knowing the content of the MR Notice. SSI expressed concern that the interpretation of the Rule in the anticipated MR Notice will be the standard against which Members will be regulated. As a consequence, SSI, IFIC and TDIS recommended that the industry be given an opportunity to comment on the proposed MR Notice, together with Rule 2.2.5, which should be re-published for comment at that time.

IFIC recommended that any requirement (such as one to disclose all products and services offered by the Member) increasing the volume of disclosure without necessarily informing the client be avoided.

Quadrus expressed support for the concept of providing information required under proposed Rule 2.2.5 to clients to assist them in making informed investment decisions but noted the importance of a balance between the amount of information that could be included as part of the disclosure and the amount that clients may reasonably read and digest. In addition, Quadrus requested including a template in a MR Notice providing guidance on Rule 2.2.5, which Members could use to assist them in the development of their own disclosure, as well as clarification as to whether the information required by the Rule needs to be contained in one separate document or if the disclosure (or pieces of it) can be placed within the various account and associated disclosure documents that are already provided to clients when they open a new account.

PFSL expressed the view that the proposed wording of Rule 2.2.5(e) may require an overly extensive description of KYC information and of how that information is used and recommended redrafting the subsection to require a plain language disclosure of the importance of investment suitability and KYC information.

IFIC expressed the view that the requirement of Section 2.2.5(e) for advisors to define the various terms with respect to KYC through written disclosure increases the volume of materials to be provided at account opening without measurable benefit to investors and should be removed. IFIC also noted that IFIC members have stated that clients may respond negatively to the level of disclosure prescribed in the Proposed Amendments, and that, due to the volume and complexity of the materials, it will be unread and unwanted.

The IFB expressed the view that commenters are not able to fully appreciate the implications of the Proposed Amendments and therefore comment on them without the benefit of reviewing future additional guidance to be provided in MR Notices. The IFB recommended that, given that a number of Approved Persons also hold other types of financial licenses and the fact that clients often hold a variety of investments outside the purview of their mutual fund advisor, certain investors be given the right to opt-out of the requirement to receive some or all of the prescribed relationship disclosure materials. The IFB expressed the opinion that, absent such an opt-out provision, in certain circumstances the regulatory reliance on KYC forms and suitability reviews can create a seemingly disparate situation, when in reality the client's asset mix and risk tolerance is in keeping with his/her overall situation. In the IFB's view, such a provision would recognize the right of clients to determine the level of service they receive from the dealer/advisor and the level of detail related to their personal and financial situation that they wish to provide to access those services. The IFB suggested that clients who choose to opt out be entitled to reverse this decision at any time.

FAIR recommended that all information pertaining to fees, charges and other advisor compensation appear in a single document written in plain language. FAIR expressed the view that allowing other documents to be incorporated by reference would diminish the benefit of simplified relationship disclosure and recommended that, since few investors actually read or review opening documents because of their length and complexity, this information be made easily accessible to investors. FAIR recommended that, at the very least, the main disclosure document include a brief summary in plain language of any incorporated documents. FAIR also recommended addressing the issues of fiduciary responsibility and the conflict of interest between the client, the Approved Person and the Member in more detail.

MFDA Response

With respect to comments that the implications of the Proposed Amendments cannot be fully appreciated without the benefit of guidance in related MR Notices, we note that the substantive requirements of the Proposed Amendments are contained in the Rule/Policy that is being amended and were explained in the Notice of publication accompanying the Proposed Amendments and staff responses to comments received during the June 2008 publication for comment. Guidance or clarification that may subsequently be issued in a companion MR Notice will clarify and not alter such requirements. Further, in an attempt to determine the impact to the membership, MFDA circulated draft sample relationship disclosure to all Members and requested feedback in February 2007.

Proposed new Rule 2.2.5 prescribes the core elements of disclosure that must be provided to clients on account opening, which may be provided in one document or several. This approach has been adopted to allow Members flexibility in how they incorporate the required disclosure on their existing forms.

The requirements of subsection 2.2.5(b) refer to generic descriptions (i.e. product type/class sold: mutual funds, GICs, exempt products, etc). Where Members only sell proprietary products or mutual funds of a related issuer, this should also be disclosed.

Subsection 2.2.5(e) does not contemplate defining all KYC terms, as it is acknowledged that certain terms, such as age, are self-explanatory. "Risk tolerance", "investment objectives" and "time horizon" are examples of key KYC terms that should be defined. MFDA staff has found that Members and clients may attribute different meanings to these terms, which may prevent clients from understanding the basis on which their investments will be assessed. Members must define KYC terms in a manner that corresponds to their sales process. The KYC terms set out and defined in Appendix 1 (Example of KYC Information) of MR-0069 are intended as examples to provide guidance to Members with respect to the type of terms to be defined and level of detail expected.

With respect to the comment that clients often hold investments not under the purview of their mutual fund advisor and, as a result, certain investors should have the right to opt-out of the requirement to receive some or all of the required disclosure, MFDA disagrees. The fact that clients may hold investments in addition to mutual funds does not mean that they do not require information about the role and responsibilities of the mutual fund dealer and the duties of an MFDA Approved Person providing products or services in respect of mutual fund assets in their account.

Clients who hold assets other than mutual funds may be under the impression that all assets that they hold are subject to the same relationship disclosure requirements. In such circumstances, providing the disclosure contemplated by Rule 2.2.5 is particularly important as it will allow the client to understand the relationship disclosure that applies in respect of their mutual fund assets (particularly as it pertains to compensation paid to the MFDA Member and the content and frequency of reporting for such assets).

The description under subsection 2.2.5(a) should address how the advisory relationship operates, which may include a statement that the client is responsible for making investment decisions but can rely on the advice given by the Approved Person and that the Approved Person is responsible for the advice and ensuring that it is suitable based on the client's investment needs and objectives. Subsection 2.2.5(d) requires a brief statement describing the Member's obligations to assess investment suitability in accordance with Rule 2.2.1 and advising the client of when (i.e. upon the occurrence of specified events) the Member will assess the suitability of the investments in the client's account.

There are a number of important disclosure documents required to be provided to clients that cannot be effectively summarized into one document. Accordingly, to satisfy the requirements of subsection 2.2.5(g), firms may refer a client to existing sources of information, e.g. the prospectus, point of sale disclosure document or offering memorandum.

Policy No. 2 *Minimum Standards for Account Supervision*

Introduction – Requirement to Obtain Approval of Alternative Procedures

IFIC acknowledged that alternative policies and procedures must adequately address the risk management issues of the Member but recommended flexibility in allowing dealers' implementation of those strategies in order to permit Members to operate according to their own business model. IFIC recommended that seeking MFDA staff approval of alternative procedures be a best practice rather than a requirement. PFSL recommended that, in the event of market changes or innovation, the MFDA approval process be expeditious to enable investor needs to be met on a timely basis.

MFDA Response

The requirement for MFDA staff pre-approval of alternate policies and procedures was requested by members of the MFDA PAC to allow Members flexibility in complying with the minimum thresholds. Pre-approval of alternative approaches allows for a level playing field among Members and a consistent level of investor protection. In light of the fact that all Members have been subject to at least two examinations, providing pre-approval to Members with alternative arrangements is a fairly simple and straightforward process. Historically, Members who wish to change their suitability framework have approached MFDA staff in advance as a prudent business practice to ensure that they are not spending time and incurring cost to implement a new structure that might not comply with MFDA requirements. Further, the pre-approval requirement would generally apply to changes to material aspects of a Member's supervisory system such as changes to the Member's trade review thresholds that deviate from the minimum standards set in the Policy.

Delegation of Procedures

IFIC expressed support for the requirements under section 4 under *Delegation of Procedures* and agreed with the MFDA's response to the first publication for comment that indicated that trades cannot be properly reviewed unless an individual has the type of experience and understanding of trade suitability procedures equivalent to a branch manager/compliance officer. IFIC recommended that the requirement be limited in scope to trade reviewers for suitability.

MFDA Response

The purpose of this section is to confirm the general principle that tasks must be delegated to individuals with the same proficiency as the delegating supervisor. The section also provides flexibility where the Member can demonstrate that the individual performing the delegated task has equivalent training, education or experience related to the function being performed.

This principle is also intended to be broader in its application, not limited to trade supervision and covers all supervisory activities.

Education

IFIC expressed satisfaction with the fact that the requirement for dissemination of relevant information contained in regulatory notices to relevant employees was amended and recommended also amending section 1 under *Education* to read: "Member's current policies and procedures manual must be made available to relevant sales and supervisory personnel."

MFDA Response

All sales and supervisory personnel should receive a policies and procedures manual. Members generally have different manuals containing policies and procedures that pertain to the functions the individuals perform. It would be expected that the individuals are provided with the manual that applies to the specific functions that they are performing.

Documentation of Client Account Information

Referring to subsection 3(o) under *Documentation of Client Account Information* regarding obtaining information required by other laws, Advocis recommended that this information not be specifically required under the Policy as Members and Approved Persons must abide by applicable federal and provincial laws.

With respect to subsections 3(g), 3(h), 3(o), 4(e) and 4(m) under *Documentation of Client Account Information* regarding obtaining information required by other laws, SSI and IFIC recommended removing these requirements from the Policy since this information is already required to be collected under existing laws and is regulated by other government agencies. The commenters expressed the view that the MFDA should not be enforcing the regulations of other regulators and recommended, where Members are unaware of other requirements, issuing MR Notices to provide additional guidance on compliance with other regulatory frameworks.

Quadrus requested clarification as to whether the requirement to provide calculation of net worth under subsections 3(n) and 4(l) was necessary and expressed the view that it is sufficient that a client simply state his or her net worth for the purpose of this section. IGM recommended amending subsection 3(n) to require Members to obtain details of the client's liquid assets only where the client is considering a leveraged investment.

With respect to section 5 under *Documentation of Client Account Information*, Quadrus requested clarification as to whether the three separate types of accounts that are required to be tracked for supervisory purposes, being: (i) registered accounts; (ii) leveraged accounts; and (iii) accounts of any registered salesperson’s family member are required to be readily identifiable if they are operating under a limited trading authorization/power of attorney or whether this qualification only refers to accounts of any registered salesperson’s family member.

MFDA Response

Through compliance reviews, MFDA staff has identified situations where Members were unaware of requirements under other relevant legislation. Accordingly, these items were included with the intention of assisting Members by providing a checklist of client information required on account opening. MFDA staff is of the view that it continues to be appropriate to include such information in this section. Further, with respect to Proceeds of Crime legislation, MFDA has an understanding with the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") that we will generally be considering Member compliance with such legislation when performing examinations in order to avoid Members being subject to duplicate examinations by FINTRAC.

Proposed Policy No. 2 has been amended to only require the details of net worth for non-registered leveraged accounts.

Changes to Know-Your-Client Information

IGM recommended amending section 1 under *Changes to Know-Your-Client Information* to require an Approved Person or Member to update KYC information only when a client advises them of a material change rather than when an Approved Person or Member becomes aware of such a change and noted that, under the IIROC proposal, this obligation is only triggered when the change is reflected in the dealer's KYC records.

RMFI and PH&N expressed support for the suggested approach to require the branch manager to review suitability upon a material change in a client's KYC information on a sample basis and recommended that the wording of section 5 under Part IV (Branch Office Supervision) of the Policy be amended to read: "The branch manager must perform a suitability review on a sample basis where a material change results in..." RMFI and PH&N recommended extending this approach to include a requirement that the Member approve all material changes in client information in accordance with proposed Rule 2.2.4(c). Further, RMFI and PH&N proposed amending section 7 under *Changes to Know-Your-Client Information* to reflect KYC reviews and approvals by Members on a sample basis.

With respect to the inclusion of guidance on branch managers' reviews of material changes and, more specifically, references to changes made to justify unsuitable trades or leveraging in section 7 under *Changes to Know-Your-Client Information*, RMFI and PH&N cautioned against including binding regulatory interpretations and examples in the Policy and recommended addressing these issues through a MR Notice.

RMFI and PH&N expressed the view that the expectation that a branch manager "be aware of situations where material changes may have been made to justify unsuitable trades or leveraging" is unduly onerous as, in most instances, such changes are done at a client's request in order to complete an unsolicited transaction. In RMFI's and PH&N's view, branch managers should be responsible for reviewing material changes in client information on a sample basis, including the review of supporting documentation that reflects details of any cautionary advice given to the client with respect to such change. RMFI and PH&N recommended removing this section from the Policy and addressing this issue in a MR Notice.

RMFI and PH&N recommended that the requirement under Section 8 under *Changes to Know-Your-Client Information* that Members provide clients with a document specifying the client's current risk tolerance, investment objectives, time horizon, income and net worth be made consistent with proposed Rule 2.2.4(c) and be limited to risk tolerance, investment objectives and time horizon. In addition, RMFI and PH&N noted that, due to possible system limitations (e.g. information that is maintained on an account level vs. at the client level), it may not be possible or appropriate to include information on income and net worth.

MFDA Response

Section 1 has been amended so that the Approved Person or Member must update the KYC information whenever they become aware of a "material change in client information". The definition of this term in Rule 2.2.4(a) has been amended and now refers to "any information ***that results*** *in changes to the stated risk tolerance…", in place of "that could reasonably result".*

The requirement of the section has been amended so that a suitability assessment of investments in each client account becomes necessary where a Member becomes aware of a material change that ***results in*** *a significant change to the stated risk tolerance, time horizon or investment objectives of the client or would have a significant impact on the net worth or income of the client.*

As section 7 now refers to approving a "material change in client information", as defined in Rule 2.2.4(a), consideration of the previous KYC information as part of such approval should be done with each such account and is not appropriate on a sample basis. MFDA staff considers the example included to be appropriate as it clarifies the regulatory intent of the section.

Section 8 was amended to remove the requirement that all KYC information that applies to the client's account be provided to the client upon material changes to the New Account Application Form ("NAAF") or KYC forms. MFDA staff regards the revised requirement (i.e. current risk tolerance, investment objectives, time horizon, income and net worth) as being the minimum information that should be provided to the client on any such NAAF or KYC changes.

Assessing Suitability of Investments with Respect to Leveraging Strategies

RMFI and PH&N expressed concern with the prescriptive approach regarding the suitability assessment of investments in consideration of a leveraging strategy. RMFI and PH&N expressed the view that the level of knowledge and participation of the Approved Person and Member in the recommendation and facilitation of the loan must be considered and that the collection of loan documentation or loan details, other than the amount of the loan, could be misleading to clients and create a perception that the loan itself is assessed for suitability. RMFI and PH&N recommended that the Approved Person and the Member only be held to standards corresponding to the proficiency requirements of a mutual fund representative/branch manager and not those of a loan specialist and that this significant issue be removed from the Proposed Amendments until further study and thorough industry consultation has taken place.

PFSL expressed the view that providing details on supervisory and disciplinary processes and procedures to Approved Persons, as required by section 4 under Part III of the Policy, could create unnecessary compliance risks as certain aspects of this type of information are key elements of the Members' compliance controls and disclosing them/such details could potentially lead to salespersons adjusting behavior in an effort to circumvent the controls.

PFSL recommended redrafting the Approved Person requirement to maintain evidence of performed suitability assessments and follow up action to place this responsibility on the Member rather than the Approved Person, as the Member would more effectively be able to establish the processes and procedures for the retention and maintenance of this information.

IGM recommended that the Member's obligation to assess the account suitability only arise prior to the time of the next trade in the account instead of immediately. IGM also recommended that the requirement to assess suitability upon a material change in the client's KYC only arise when that change has been communicated by the client and not when the Member or the Approved Person becomes aware of the change.

MFDA Response

If an Approved Person does not have sufficient proficiency to determine if a client is able to manage the financial obligations of a loan, then the Approved Person, who is obligated to act in the best interest of clients, should not recommend clients borrow to invest. MFDA staff has, however, noted the concern that additional proficiency may be required for Approved Persons with respect to leveraging and will address this with the course and exam providers.

It is not expected that the Member provide detailed explanations regarding their trade supervision and disciplinary processes to Approved Persons. Rather the requirement to communicate supervisory and disciplinary processes to Approved Persons was meant to provide general guidance to Approved Persons regarding the Member's suitability standards and the consequences of non-compliance.

With respect to maintaining evidence of suitability assessments and follow-up action, Members are already required to maintain evidence of their supervisory activity. Part 7 under Section III requires Approved Persons to evidence they have complied with their obligation to perform a suitability assessment as required under proposed Rule 2.2.1(e).

Policy No. 2 requires the Approved Person to assess the suitability of investments in each client account within a reasonable time, but, in any event, no later than the time of the next trade. The determination of reasonable time in a particular instance will depend on the circumstances surrounding the event giving rise to the requirement to perform the suitability assessment. The requirement is intended to ensure that a suitability review is performed as soon as reasonably possible following the trigger event. If a review were required only prior to the time of the next trade, a significant period of time may have elapsed between the trigger event and the suitability review.

Branch Office Supervision

Branch Office Supervision – Daily Reviews

SSI expressed the view that the daily branch office review requirements are too prescriptive and depart from the principle-based approach in the Policy. SSI recommended that Members be able to establish daily trade review standards that reasonably address management objectives. SSI expressed the view that the proposed thresholds are too low and complex and will result in a significant increase in the complexity of daily reviews and systems changes to generate trading blotters that differentiate trades based on dollar amount and risk, with no measurable increase in investor protection. SSI noted that such daily blotters will be complex and voluminous and these requirements will increase the probability of human error in the review process and decrease the quality of the review. SSI commented that trades of higher monetary value are more risky and the risks respecting trades under $10,000 can be managed internally by Members. SSI and IFIC recommended adopting a simple minimum threshold for branch level daily trade reviews of $10,000 for all trades and redemptions.

IGM expressed the view that the requirement that the branch manager review all initial trades is unnecessary and recommended that Members instead be required to implement a monitoring process to review appropriate initial trades as part of an integrated oversight model. IGM acknowledged that the review thresholds have been increased from the previous version of the Proposed Amendments, but recommended that the Policy provide Members with flexibility to use a risk-based approach to determine which trades in the securities should be reviewed rather than prescribe specific threshold amounts.

IFIC acknowledged that it is prudent for dealers to monitor possible outside business activity where money may be leaving the Member for reinvestment into other potentially inappropriate or unauthorized investments; however, it recommended removing the requirement that the branch manager assess the impact and appropriateness of any redemption charges and the suitability of the redemption with regard to the composition of the remaining portfolio. IFIC expressed the view that deferred sales charges are set at the time of initial sale and are fully explained in the text of the prospectus and minimizing sales charges should be viewed as one of several considerations a representative should consider in recommending to a client a strategy for managing redemptions. In IFIC's view, other considerations might include taxation and impact of the redemptions on investment mix. IFIC recommended that the branch manager not be responsible for a re-assessment of the previous review, but rather be required to ensure that there is a consistent and robust evidence of the assessment, as trade suitability assessment is required at the advisor level.

IFIC expressed the view that mandating a branch manager to assess the investment suitability in each client account upon a material change in KYC information will create redundancies as the review is already assessed at the advisor level under Rule 2.2.1(e)(1). IFIC recommended that the branch manager "supervise" rather than "assess" the suitability of investments.

MFDA Response

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

The trade review thresholds are risk-based. In developing the trade review thresholds, MFDA compliance staff examined the review thresholds used by Members and determined that 80% of Members were already conducting the proposed types of trade reviews. Further, since the issuance of proposed Policy No. 2, Members who previously did not meet the recommended trade thresholds have updated their policies and procedures to be consistent with the proposed Policy. Therefore, we estimate the number of Members currently in compliance with the proposed Policy No. 2 trade review thresholds is much greater than 80%.

With respect to branch manager review of initial trades, members of the MFDA PAC suggested this requirement, as the branch manager is already required to approve new accounts and the majority of initial trades occur at the same time an account is opened.

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

In terms of assessing the impact and appropriateness of redemption charges, the fact that a client obtains prospectus disclosure at the time of the purchase does not negate the obligation of Members and Approved Persons to act in the best interest of clients. Where redemptions are recommended and result in significant charges, this is a factor that should be considered in assessing the suitability of the redemption transaction itself.

Branch manager supervision of suitability necessitates that the branch manager perform a suitability assessment. Effective supervision requires not only an assessment of *whether the task was performed, but also an assessment of whether it was performed properly.*

Branch Office Supervision – Redemptions

RMFI and PH&N recommended removing the detailed guidance on reviews of redemptions from Policy No. 2 and instead providing it in MR Notices. RMFI and PH&N suggested adopting a risk-based approach to the review of redemptions with more detailed guidance provided in supporting documents. For example, an expectation that each and every redemption over $10,000 be reviewed and assessed against the points indicated in Section 3 of Part IV of the Policy may not be appropriate or necessary in all circumstances. RMFI and PH&N recommended that branch managers be required to consider these points where red flags are raised that may be indicative of improper activity. RMFI and PH&N also agreed with industry commentators who pointed out that monitoring subsequent purchases at another firm for "potentially inappropriate" investments is neither possible nor enforceable.

Given that redemptions may occur without the Approved Person's involvement, for example on client-name accounts, PFSL recommended that this section be redrafted to require the branch manager to conduct the reviews only in instances where the Approved Person has been directly involved.

MFDA Response

Proposed Policy No. 2 does not require monitoring of subsequent purchases at another firm. Rather, it requires the application of reasonable judgment when reviewing redemptions to consider whether, based upon the branch manager's knowledge of the Approved Persons' activities, the amount or pattern of redemptions is unusual, which may indicate an outside business activity. Where the branch manager has identified unusual activity, the branch manager should take additional steps to resolve the concern.

Approved Persons contact fund companies directly to place redemption orders and Approved Persons may also advise clients to contact fund companies directly to process redemptions. Knowing whether or not an Approved Person "was involved" in the redemption is difficult to ascertain without contacting the client in each case. Given that this would be impractical to do, the distinction has not been incorporated into the criteria.

Branch and Head Office Supervision – Simplifying the Requirements

PFSL recommended simplifying the thresholds for reviews of trading and account activities and suggested that the reviews be based on the level of risk associated with the activities, which is not necessarily related to the dollar amount or whether or not the trade was an initial or subsequent investment. PFSL expressed the view that the differing thresholds make these sections unnecessarily complex and recommended setting the thresholds at a common amount of $10,000 in order to streamline the requirements and place the emphasis on the risks associated with the previous day's trading and account activities.

IFIC expressed the view that the branch and head office daily review requirements will add compliance requirements that have not been justified in terms of improved supervision, creating additional workload for the branch manager and head office that will be unmanageable and will decrease the current quality of supervision with no identified benefit for consumers or the regulatory process itself.

MFDA Response

In developing the trade review thresholds, MFDA Compliance staff examined the review thresholds used by Members and determined that at least 80% of Members conduct the proposed types of trade reviews. Since the issuance of proposed Policy No. 2, Members who previously did not meet the recommended trade thresholds have updated their policies and procedures to be consistent with the proposed Policy. Therefore, we estimate that the number of Members currently in compliance with the proposed Policy No. 2 trade review thresholds is much greater than 80%. Further, based upon our review of larger firms with the most trade volume, the average mutual fund trade is well under $10,000 which would mean that adopting such criteria would result in most trades not being subject to a suitability review.

With respect to the comment that the branch and head office daily review requirements are not justified, we note that these requirements (particularly the proposed trade review thresholds) have been adopted in response to requests for more direction from Members and address compliance issues identified during staff reviews of Member branch supervision procedures and issues identified by MFDA Enforcement staff while assessing and investigating cases.

Head Office Supervision

Head Office Supervision – Daily Reviews

SSI and IFIC expressed the view that the proposed head office daily review thresholds are too low and complex and recommended adopting a simple minimum threshold for head office daily reviews of $50,000 for all trades and redemptions. IFIC agreed that the appropriate threshold level for exempt securities should be $5,000. IFIC expressed the view that a higher level threshold would allow for an effective monitoring system to be implemented as an oversight review for unsuitable investments in a client account and noted that Members may exceed the requirements by reviewing trades below the recommended level as prudent practice.

IGM expressed the view that the requirements of this section largely duplicate the branch office reviews, which is not the most effective use of head office resources.

MFDA Response

In developing the trade review thresholds, MFDA Compliance staff examined the review thresholds currently used by Members and determined that 80% of Members presently conduct the proposed types of trade reviews. With respect to comments indicating that the proposed head office reviews are duplicative of those performed at the branch level, head office reviews are intended to detect unsuitable investments and excessive trading and serve the purpose of exercising effective oversight of branch office operations. Higher trade thresholds and sampling of suitability of investments allow such reviews to be less detailed than those required at the branch level, while still being effective as an oversight review for unsuitable investments and excessive trading.

Identification of Trends in Trading Activity

RMFI and PH&N expressed concern with the unnecessarily prescriptive approach to the identification of trends and noted that this area would be best suited for a risk-based approach in accordance with Members' business models and unique risks and circumstances such as product offering, sales force compensation, structure and available technology. RMFI and PH&N recommended removal of this section from the Policy and addressing it in a MR Notice.

PFSL and IFIC expressed the view that the requirements for supervisory procedures under section 2 of *Identification of Trends in Trading Activity* are unnecessarily prescriptive as some Members may have more complex and effective procedures for finding and addressing these issues and recommended including a clause allowing Members to utilize alternative, MFDA-approved methods and procedures or providing related guidance in a MR Notice. IFIC expressed the view that the proposed requirements increase the level of compliance with checks at the advisor, branch manager and head-office levels, which puts a burden on the firm supervisory roles and raises industry costs without any corresponding enhancement of consumer protection.

IGM expressed the view that the requirement to review all accounts generating commissions of greater than $1,500 per month under section 2 is of limited use and that general commission trend monitoring, which is set out elsewhere in this section, is more effective and recommended deleting this requirement.

IFIC expressed the view that the commission review requirement will result in an unnecessarily high number of exceptions to be reviewed.

IFIC noted that the requirements under section 2 are not flexible enough to account for certain events, for example, a market upswing, during which an advisor may experience significant increases in assets under administration ("AUA") or, as acknowledged by the MFDA, different business structures, e.g. where the Approved Person is compensated exclusively on a salary basis. IFIC expressed the view that the head office requirement to perform quarterly reviews on AUA with a comparison to the same period in the previous year will generate meaningless reports without any benefit. IFIC recommended removing the requirements with respect to commissions greater than $1,500 and reports of AUA.

MFDA Response

Under MR Notice MR-0065 – Churning ("MR-0065"), Members are advised to have policies and procedures to detect instances of churning or excessive trading and properly address these situations. MFDA staff has received inquiries from Members requesting more detail in respect of the policies and procedures that would be appropriate under MR-0065 and the Proposed Amendments have been developed in response to such requests. If a Member has a specific business structure in which the risk of churning is not present (e.g. where Approved Person is compensated exclusively on a salary basis), not all of these reviews would be necessary.

The trend reports in proposed Policy No. 2 are intended to assist in identifying unusual, excessive trading patterns. In developing these standards, we considered existing industry practices and the standards in place at other regulators. Further, Members and back-office service providers have already made systems changes to provide the types of reports outlined in proposed Policy No. 2.

With respect to comments suggesting that the requirements under section 2 are not sufficiently flexible to account for significant increases in AUA, the requirements contemplate such increases. Section 2 refers to "Significant increases in commissions or AUA ***beyond those caused by market fluctuations****" as ones that may indicate issues with churning or leveraging strategies. In addition, significant increases in AUA or commissions identified in the required reporting would be explainable, were they due to a market upswing, as a general trend of such increases over the quarter would be observed across the industry.*

Rule 2.8 (Client Communications)

Communicating the Rate of Return

FAIR recommended mandating provision of a personalized rate of return to clients on their statements in relation to the performance of the relevant benchmarks, in order to allow clients to truly assess how their investments are faring. FAIR expressed the view that a majority of Members are able to overcome practical difficulties of providing such calculations and recommended that the MFDA and the CSA require calculating and reporting client portfolio returns at least annually, as well as mandate the inclusion of the returns of the relevant benchmarks.

MFDA Response

Rule 5.3.5 requires Members to provide their clients with account performance reporting on an annual basis. We note that the provision of rate of return information for relevant benchmarks was considered by the CSA/SRO working group addressing account performance reporting requirements. Difficulties were identified with adopting such a requirement, including the fact that there is no one standard or relevant performance benchmark applicable for all accounts. Inappropriate use of performance benchmarks *could result in clients adjusting the composition of their portfolios or otherwise making investment decisions that are inconsistent with their identified investment objectives as they seek to pursue the benchmark.*

We note that the provision of performance benchmarks are not prohibited under Rule 2.8.3 provided that benchmarks provided to a client are relevant to that client's portfolio and not used in a manner that is misleading.

Requirement for Member to Approve Any Client Communication

Advocis reiterated its concerns noted during the first publication, noting that the proposed requirement under Rule 2.8.3(b) may be interpreted to apply to all Approved Person communications, whether written or oral and recommended amending this section by removing the word "any" to clarify this section.

MFDA Response

The section does not require further clarification.

*As noted, the requirements in proposed Rule 2.8.3(b), refer to "client communication", which is defined in Rule 2.8.1 as "**any written communication**" by a Member or Approved Person to a client of the Member, including trade confirmations and account statements, other than an advertisement or sales communication". Accordingly, only written communications and not verbal conversations that reference performance are subject to the requirements of Rule 2.8.3(b). In addition, Rule 2.8.3 requires Member supervision of client communications containing a rate of return regarding a specific account or group of accounts and does not require Member supervision of a rate of return provided for specific products.*

Rule 5.3 (Client Reporting)

Client Reporting

RMFI and PH&N expressed concern that the Proposed Amendments are not harmonized with other regulators' client reporting requirements. For example, RMFI and PH&N noted that proposed NI 31-103 will require all dealers, including mutual fund dealers, to deliver account statements every three months for both client name and nominee name accounts and therefore further consequential amendments to the MFDA Rules will be required to harmonize with NI 31-103. RMFI and PH&N recommended that the client reporting requirements not be finalized at this time in order to avoid unnecessary confusion.

IGM expressed concern that a number of the key terms used in Rule 5.3.5, including total assets deposited and withdrawn, remain undefined and recommended clarification of the requirement in section 5.3.5 (a)(v) to include gains and losses. IGM noted that if this requirement is meant to reflect changes in value, it may not be a concern, however, if it is intended to reflect potential tax consequences it would be. For clarity, IGM recommended addressing this issue either through amendments to the proposed Rule or, alternatively, through an MR Notice providing further guidance in this area.

FAIR expressed support for the requirement to provide the gain and loss in the account as at the end of the reporting period and noted that this is a logical step forward in order to facilitate investors' access to the key information relating to their investments.

IFIC acknowledged the fact that investors should receive basic, core information on the performance of their investments annually; however, it expressed the view that the Proposed Amendments are too prescriptive in this regard. IFIC recommended focusing primarily on a requirement that full disclosure be provided to the client, via the Relationship Disclosure Document, on the specifics of the provided performance information and its delivery and providing Members with flexibility with regard to specific information to be provided and methodology to be used for its delivery.

IFIC expressed the view that there remains confusion as to the requirement for annual reporting and requested clarification whether a quarterly statement is to contain activity and performance information for the quarter and for the previous three quarters.

MFDA Response

The MFDA has made consequential amendments to MFDA Rules to conform to requirements under NI 31-103. These amendments to reflect NI 31-103 do not impact the proposed changes for performance reporting.

The Proposed Amendments permit flexibility regarding the method of disclosing performance information (either as a percentage or dollar value of the key components). Further, the method of delivery has not been prescribed. Performance return information must be provided annually. This information can be incorporated into an account statement or can be provided separately.

Quarterly account statements must include an activity report for each transaction made by the client during the period covered by the statement (i.e. during the quarter). Under proposed Rule 5.3.5, the Member must provide account performance reporting on an annual basis. If a Member chooses to provide such information more frequently (e.g. by including it on the quarterly statement), it must be provided on an annualized basis.

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