

## **Summary of Public Comments Respecting Proposed Amendments to Section 1 (Definitions) of MFDA By-law No. 1, Rule 2.5.5 (Branch Manager) and Policy No. 2 *Minimum Standards for Account Supervision***

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On January 4, 2013, the British Columbia Securities Commission (“BCSC”) published for a 90-day public comment period proposed amendments to section 1 (Definitions) of MFDA By-law No. 1, Rule 2.5.5 (Branch Manager) and Policy No. 2 *Minimum Standards for Account Supervision*.

The public comment period expired on April 4, 2013.

Ten submissions were received during the public comment period:

1. Association of Canadian Compliance Professionals (“ACCP”);
2. The Canadian Advocacy Council for Canadian CFA Institute Societies (“Canadian Advocacy Council”);
3. Debra McFadden;
4. Desjardins Financial Services Firm Inc. (“DFSF”);
5. Independent Planning Group Inc. (“IPG”);
6. The Investment Funds Institute of Canada (“IFIC”);
7. Investment Planning Counsel (“IPC”);
8. Kenmar Associates (“Kenmar”);
9. Portfolio Strategies Corporation; and
10. Quadrus Investment Services Ltd. (“Quadrus”).

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

### **Support for the Proposed Amendments**

Seven commenters expressed support for the proposed amendments, noting that they strike an appropriate balance between providing Members with flexibility in developing branch supervisory structures while maintaining adequate checks and balances to ensure that such structures operate effectively. Commenters also expressed a desire for the proposed amendments to become effective as soon as possible, so that, in this respect, MFDA Members can benefit from a regulatory framework similar to the one currently available to members of IIROC.

Commenters also agreed that the proposed amendments are consistent with the public interest and highlighted key features of the proposed amendments which are intended to ensure that adequate supervision continues to be performed at the branch and sub-branch levels.

One commenter noted that, to avoid actual or perceived conflicts of interest, branch managers should be at arm's length from the registered representatives they supervise and

should not be directly employed by or receive remuneration from such individuals. Another commenter indicated that the ability to directly employ and assign an off-site branch manager to a location will reduce conflicts of interest that may exist where: producing advisors also perform branch manager duties (part-time) while spending the majority of time advising clients (their own book of business); branch managers are directly employed by the advisors they are obligated to supervise; and branch managers are compensated by way of an override (percentage) of commissions earned by the advisors they are supervising.

### **MFDA Response**

Staff thanks all commenters for their input and acknowledges comments expressing support for the proposed amendments.

### **Concerns with the Proposed Amendments**

An investor association noted that, in its experience, an on-site branch manager is in the best position to know dealer representatives in the office and clients at that location and to assess and address client needs and compliance issues. It was noted that permitting greater leeway to designate off-site branch managers could have a negative impact on investor protection and that it is difficult to properly supervise registered representatives from an off-site location, even with periodic visits, as the branch manager is unlikely to have strong relationships with representatives and other staff at the branch. It was also noted that key protections and the opportunity for early detection of issues are lost when branch managers cannot observe the daily administrative functions at the branch.

Commenters noted that branch managers perform an important gatekeeper function, should be subject to stringent education and proficiency requirements, should not perform other functions at a Member and should, in most circumstances, be held accountable for rule breaches committed by those under their direct supervision. It was noted that by allowing branch managers to supervise from off-site locations, it is possible that staff is sending a message that supervision and responsibility for compliance need only be on an intermittent basis.

A commenter indicated that a Member's system of compliance and supervision must be adequate to identify and address issues, in a timely manner, at all levels of a Member's supervisory structure. The commenter expressed concerns that this would be more difficult with the increased flexibility permitted by the proposed amendments and recommended, instead, that rules respecting branch office supervision be tightened.

### **MFDA Response**

The proposed amendments to Policy No. 2 set out a list of factors to be considered when determining whether an on-site branch manager is necessary at a branch, including considerations intended to assess the risk profile of the Member. The purpose of this list of factors is to assist the Member in its assessment of whether, from a risk perspective, a

proposed branch supervisory structure involving remote supervision is appropriate in meeting regulatory objectives/requirements under MFDA Rules, or whether the supervision of an on-site branch manager would be more appropriate.

The proposed amendments are intended to create a level playing field for MFDA Members by harmonizing with requirements under NI 31-103 and IIROC rules, which are not as prescriptive in respect of requirements for branch supervisory structures.

The objective of the proposed amendments is 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. The flexibility permitted by the proposed amendments is not intended to reduce the level of supervision to which branches are currently subject.

### **Systems/Technology Issues**

An investor association expressed concern that, as a result of a lack of integration between new systems and legacy systems, the proposed amendments could result in significant technology costs to allow for upgrades that would enable integrated access to centralized data. The commenter indicated that such systems integration is necessary, as it would support automated compliance review and facilitate more robust remote branch management/supervision.

### **MFDA Response**

Staff notes that the proposed amendments offer Members flexibility in determining how to best supervise their branches, but do not require that Members make any changes to their existing compliance or branch supervisory structures/practices.

Members choosing to take advantage of the flexibility offered under the proposed amendments will have to demonstrate that they have the appropriate systems in place to allow for remote supervision. In this regard, Members will first have to take into consideration any costs that may be associated with any systems upgrades that may be necessary.

### **MFDA Pre-Approval for Designation of Off-Site Branch Managers**

A commenter expressed the view that the requirement to obtain MFDA pre-approval to designate off-site branch managers is unnecessary, noting that Policy No. 2, Part IV (Branch Supervision), already sets out specific factors to be considered in determining whether an on-site branch manager is necessary.

Other commenters encouraged the MFDA to ensure that the pre-approval process is efficient and simple.

## **MFDA Response**

The pre-approval process will allow staff to assess a Member's proposal for an alternate branch supervisory structure, having regard to a number of factors. The requirement for pre-approval is consistent with existing requirements under Policy No. 2. Currently, under Policy No. 2, 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 the Policy must demonstrate that all of the principles and objectives of the minimum standards set out in the Policy have been properly satisfied. Further, any such alternative policies and procedures must be pre-approved by MFDA staff before implementation.

Many Members currently approach MFDA staff before making major changes to their compliance and supervisory structures to avoid having to address issues identified through a compliance review at a later date. We note that the requirement for prior approval is also consistent with IIROC registration practice.

As part of the pre-approval process, MFDA compliance staff would review the Member's overall branch supervisory structure, rather than performing a review on a location-by-location basis. The purpose of this review would be to generally assess the Member's supervisory structure as a whole. The effectiveness of the Member's implementation of its supervisory structure would be assessed by staff as part of the compliance examination process. Staff will issue guidance to Members that will provide additional details in respect of the pre-approval requirements under Rule 2.5.5(c), at the time that the proposed amendments come into effect.

## **Periodic Branch Visits/Pre-Approval of Remote Supervision**

A commenter noted that frequent in-person visits to each sub-branch location are not required for proper supervision. This commenter noted that various technological advances, which are commonly used and available, have greatly diminished the need for in-person meetings and increased the ability of a supervisor and Approved Person to be in contact despite any distance. The commenter also noted that, for independent dealers, most sub-branches are operated by a single Approved Person and that, in many instances, it will not be economical for supervisors to take the time to make frequent visits to each sub-branch, particularly those located in rural areas. This commenter recommended that Members be allowed to determine the frequency of in-person visits to sub-branches, subject to the requirements of Policy No. 5.

In addition, the commenter expressed concerns with the requirement that only the designated branch manager may perform supervisory visits to a sub-branch, noting that a supervisor who supervises many Approved Persons who are each in separate branches located, for example, in rural areas, could easily spend most of their time travelling between locations, with little time left for trade and account reviews and other aspects of supervision. The commenter recommended that Members be permitted to determine which supervisory staff should visit sub-branch locations. The commenter also expressed

the view that the proposed amendments should permit the Member to determine whether a supervisory visit can be combined with a Policy No. 5 branch review.

A commenter noted that since the requirement for periodic branch visits is not in existing Policy No. 2, it represents a material change, contrary to the MFDA's assessment.

Several commenters requested clarification as to what tasks would have to be performed by the branch manager during the periodic visits.

Commenters asked that a guidance Notice, setting out the type of information that will have to be provided to the MFDA to obtain pre-approval, be issued shortly after any proposed amendments are adopted, as opposed to following staff's review of requests for remote supervision. It was noted that this would allow Members to analyze their current branch structure to determine which, if any, branches may be candidates for changes to their supervision structure. Commenters also sought written guidance/details in respect of how the pre-approval process under Rule 2.5.5(c) will work.

### **MFDA Response**

Proposed amendments to Policy No. 2 require periodic visits to the branch and sub-branch by the off-site branch manager, as necessary, to ensure that business is being properly conducted at the location. As this requirement is intended to be principle-based, a minimum frequency for such visits has not been prescribed. Consistent with the views of other SROs, an annual periodic visit to the branch would generally be acceptable. However, the frequency of periodic visits to branches/sub-branches would ultimately depend on the risk level assigned to the branch by the Member, in accordance with the risk criteria set out under the proposed amendments to Policy No. 2. In determining the frequency of the periodic visits, Members should also consider their Policy No. 5 branch review schedule. Where a Member has conducted a Policy No. 5 branch review of a location in a given year, and there are no significant findings and/or subsequent events, the periodic visit required under the proposed amendments to Policy No. 2 may not be required to be performed in the same year. Staff would not expect periodic branch/sub-branch visits, as required under the proposed amendments, to be as comprehensive or as detailed as branch reviews required under Policy No. 5.

Policy No. 2 has been amended to clarify that other Approved Persons at the Member delegated supervisory responsibility may perform the periodic visits required under the proposed amendments, provided that: such staff are sufficiently qualified and have no conflicts of interest; there are procedures to ensure that information about the branch or sub-branch is communicated to the individual performing the review; and that the individual performing the review reports issues identified to the Chief Compliance Officer. When selecting individuals other than the off-site branch manager to perform the periodic branch/sub-branch visits required under the proposed amendments, Members must ensure that such individuals meet the requirements under Policy No. 5 respecting qualifications for reviewers.

Staff will issue a guidance Notice when the proposed amendments are adopted which will set out additional details and clarification in respect of: tasks/functions to be performed by an off-site branch manager during periodic branch/sub-branch visits; how the pre-approval process under Rule 2.5.5(c) would work; and factors that will be considered by MFDA staff in reviewing requests for remote supervision arrangements.

### **Number of Branches Assignable to a Remote Branch Manager**

Commenters sought clarification as to whether the MFDA will allow Members to assign one remote branch manager to more than one branch location.

### **MFDA Response**

Rule 2.5.5(c) does not preclude Members from assigning an off-site branch manager for more than one branch/sub-branch location. However, we note that the scope of remote supervision (i.e. the proposed number of locations that a remote branch manager would be supervising) is a factor that staff would take into consideration when reviewing the effectiveness of a Member's branch supervisory structure.

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