

# MUTUAL FUND DEALERS ASSOCIATION OF CANADA

## PROPOSED AMENDMENTS TO MFDA RULE 1.1.6

### (INTRODUCING AND CARRYING ARRANGEMENT)

#### **I. OVERVIEW**

##### **A. Current Rule**

Rule 1.1.6(b)(viii) currently requires that, at account opening, the introducing dealer advise the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer.

Rule 1.1.6(b)(ix) currently requires the name and role of each of the carrying dealer and the introducing dealer to be shown on all contracts, account statements and confirmations. The Rule requires the carrying dealer to be responsible for sending account statements and confirmations to clients introduced to it by the introducing dealer to the extent such statements and confirmations relate to trading or account positions in respect of which the carrying dealer has provided services.

Rule 1.1.6(b)(x) currently provides Level 3 and Level 4 introducing dealers with the option to comply with the disclosure requirements under 1.1.6(b)(ix) by providing written disclosure at least annually to each of its clients whose accounts are being carried by the carrying dealer, outlining the relationship between the introducing dealer and the carrying dealer and the relationship between the client and the carrying dealer.

Rule 5.4.1 currently requires Members who have acted as principal or agent in connection with any trade in a security to send to the client a written confirmation of the transaction containing the information required under Rule 5.4.3. The Rule provides that a Member need not send this trade confirmation where the manager of the mutual fund sends the client a written confirmation containing the required information.

##### **B. The Issues**

Rule 1.1.6(b)(viii) is intended to ensure that, at the time of account opening, each client receives adequate disclosure of the relationship between the introducing dealer and carrying dealer and the carrying dealer and the client. The MFDA has received comments from Members that, where the particulars of the disclosure are provided as prescribed and in a way that clearly explains the relationships between the parties, it is not necessary to specify the party that must prepare and develop this disclosure.

Rule 1.1.6(b)(x) is intended to create flexibility by providing an alternate way for Level 3 and 4 introducing dealers to meet the requirements of Rule 1.1.6(b)(ix). Level 1 and 2 dealers

cannot presently rely on the flexibility offered by this section. The MFDA has received comments from Members that the current requirement for ongoing disclosure of the name and role of the introducing dealer and carrying dealer on contracts, account statements and trade confirmations is not necessary to ensure that clients understand the parties involved in processing their trades and that the annual disclosure option should be extended to Level 1 and 2 introducing dealers.

Rule 5.4.1 is intended to avoid duplication by providing Members with relief from the requirement to send a written trade confirmation where the manager of the mutual fund sends a client a written confirmation containing the required information. Carrying dealers are presently required by Rule 1.1.6(b)(ix) to send written confirmation of a trade in a security of a mutual fund to clients. However, mutual fund managers also send trade confirmations to clients in respect of the same trades.

### **C. Objectives**

The objective of the proposed amendments is to allow an appropriate degree of flexibility in how Members meet the disclosure requirements of the Rule while continuing to ensure that clients are informed about the role and identity of the carrying dealer. The proposed amendments will also permit carrying dealers to rely on the trade confirmations sent by mutual fund managers, where such confirmations contain the information required to be sent under Rule 5.4.3.

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

The proposed amendments will allow Members greater flexibility in meeting their disclosure obligations and avoid duplication by allowing Members to rely on written trade confirmation statements sent by mutual fund managers. The proposed amendments will avoid client confusion arising from the delivery of duplicative information while also reducing unnecessary production and mailing costs for the industry.

The proposed amendments create greater flexibility and do not impose additional requirements. As a result, it is not expected that the proposed amendments will have a significant effect on Members, other market participants, market structure or competition. It is also not expected that proposed amendments will generate additional compliance costs.

## **II. DETAILED ANALYSIS**

### **A. Proposed Amendments**

The proposed amendments to Rule 1.1.6(b)(viii) are intended to clarify that either the introducing dealer or carrying dealer can prepare or develop the disclosure by removing the reference to the introducing dealer advising the client of the relationship. The proposed amendments will require the introducing dealer to ensure that the client receives the requisite disclosure document on account opening.

The proposed amendments to Rule 1.1.6(b)(viii) will also remove the requirement that, in the case of a Level 2 introducing dealer, the client's acknowledgment of disclosure reflect that the introducing dealer has advised the client that the carrying dealer shall be responsible for and shall maintain in its name any trust accounts established in respect of cash received from clients and that all client cheques shall be payable to the carrying dealer. Under proposed Rule 2.2.5(c) (Relationship Disclosure), the Member will be required to provide the client with disclosure describing the Member's policies and procedures regarding the receipt and handling of client cash and cheques. In the case of a Level 2 dealer, the disclosure must include an explanation that all client cheques shall be payable to the issuer or carrying dealer, as applicable.

The proposed amendments to Rule 1.1.6(b)(x) will allow Level 1 and 2 dealers to use the annual disclosure option set out in that Rule as an alternate way to fulfill the requirements of Rule 1.1.6(b)(ix).

Proposed subsection 1.1.6(b)(xii) will provide that the carrying dealer need not send a written confirmation of a trade in a security of a mutual fund where the manager of the mutual fund sends the client a written confirmation containing the information required to be sent under Rule 5.4.3.

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

No other issues or alternatives were considered.

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

The proposed amendments are consistent with the Investment Dealers Association of Canada ("IDA") disclosure requirements for Type 2 introducing/carrying broker arrangements set out in By-law No. 35.

IDA Type 2 introducing brokers have the ability to handle cash and facilitate cash transactions on behalf of clients through the use of an account in the name of the introducing broker. IDA Type 2 introducing brokers, like Type 3 and 4 introducing brokers, have the option under IDA By-law No. 35 of providing written disclosure to clients of the relationship between the introducing broker and the carrying broker either on an annual basis or on an ongoing basis on all contracts, account statements and trade confirmations.

Under MFDA Rules, carrying dealers in Level 2 introducing/carrying dealer arrangements are responsible for and maintain in their name any trust accounts established in respect of cash received from clients and all client cheques must be payable to the carrying dealer. With respect to the Level 2 introducing/carrying dealer arrangement, the MFDA currently requires that the carrier's name and role be on all contracts, account statements and trade confirmations. The proposed amendments will eliminate this difference between IDA By-law No. 35 and MFDA Rule 1.1.6 by extending the annual disclosure option that is currently

available to Level 3 and 4 introducing dealers to Level 1 and 2 introducing dealers.

The proposed amendments to Rule 2.2.5 (Relationship Disclosure) will underscore the importance of the role of the carrying dealer in MFDA Level 2 introducing/carrying dealer arrangements by requiring disclosure of Member's procedures regarding the receipt and handling of client cash and cheques.

**D. Systems Impact of Amendments**

It is not anticipated that there will be a significant systems impact on Members as a result of the proposed amendments.

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

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

**F. Public Interest Objective**

The proposed amendments will improve the Rule by creating greater flexibility and avoiding client confusion arising from the delivery of duplicative information, while continuing to serve the public interest by ensuring that clients understand the role of the carrying dealer in processing their trades and receive detailed information with respect to their trades.

**III. COMMENTARY**

**A. Filing in Other Jurisdictions**

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

**B. Effectiveness**

The proposed amendments are simple and effective.

**C. Process**

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on May 22, 2008.

#### **D. Effective Date**

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

#### **IV. SOURCES**

MFDA Rule 1.1.6

MFDA Rule 5.4

#### **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 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Sarah Corrigall-Brown, Senior Legal Counsel, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at: [www.mfda.ca](http://www.mfda.ca).

Questions may be referred to:

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

## MUTUAL FUND DEALERS ASSOCIATION OF CANADA

### INTRODUCING AND CARRYING ARRANGEMENT (Rule 1.1.6)

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 1.1.6:

#### **Rule 1.1.6 – (Introducing and Carrying Arrangement)**

##### **1.1.6 Introducing and Carrying Arrangement**

(b) **Terms of Arrangement.** A Member may enter into an agreement with another Member in accordance with Rule 1.1.6(a) if it satisfies the following requirements:

(viii) Disclosure and Acknowledgement on Account Opening. At the time of opening each client account, the introducing dealer shall ensure that the client receives written disclosure explaining the introducing dealer's relationship to the carrying dealer and the relationship between the client and the carrying dealer and, in the case of a Level 1 introducing dealer, shall obtain from the client an acknowledgement in writing to the effect that such disclosure has been received by the client;

(ix) Contracts, Account Statements, Confirmations and Client Communications. The name and role of each of the carrying dealer and the introducing dealer shall be shown on all contracts, account statements, confirmations and, in the case of a Level 1 introducing dealer, all client communications (as defined in Rule 2.8.1) and advertisements and sales communications (as defined in Rule 2.7.1) sent by either the introducing dealer or the carrying dealer in respect of accounts carried by the carrying dealer. In the case of a Level 1 introducing dealer, the name and role of the carrying dealer shall appear in at least equal size to that of the introducing dealer. The use of business or trade or style names shall be in accordance with Rule 1.1.7 as applicable;

(x) Annual Disclosure. A Level 1, 2, 3 or 4 introducing dealer may comply with the disclosure requirements under paragraph (ix) by providing written disclosure at least annually to each of its clients whose accounts are being carried by the carrying dealer, outlining the relationship between the introducing dealer and the carrying dealer and the relationship between the client and the carrying dealer;

(xi) Clients Introduced to the Carrying Dealer. Each client introduced to the carrying dealer by the introducing dealer shall be considered a client of the carrying dealer for the purposes of complying with the By-laws and Rules to the extent of the services provided by the carrying dealer;

(xii) Responsibility for Reporting. The carrying dealer shall be responsible for sending account statements and confirmations to clients introduced to it by the introducing dealer as

required by the By-laws and Rules to the extent such statements and confirmations relate to trading or account positions in respect of which the carrying dealer has provided services. The carrying dealer need not send a written confirmation of a trade in a security of a mutual fund where the manager of the mutual fund sends the client a written confirmation containing the information required to be sent under Rule 5.4.3; and

(xiii) Responsibility for Compliance. Unless otherwise specified in Rule 2 or in this Rule 1.1.6, the introducing dealer which is a Level 1 Dealer and its carrying dealer shall be jointly and severally responsible for compliance with the By-laws and Rules for each account introduced to the carrying dealer by the introducing dealer, and in all other cases the introducing dealer shall be responsible for such compliance, subject to the carrying dealer being also responsible for compliance with respect to those functions it agrees to perform under the arrangement entered into under this Rule 1.1.6.