

## Chapter 13

# SRO Notices and Disciplinary Proceedings

---

---

### 13.1.1 MFDA Policy 5 – Branch Review Requirements

#### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

#### BRANCH REVIEW REQUIREMENTS [POLICY 5]

*This Policy 5 is black-lined to indicate amendments from the version that was published on September 23, 2005 at (2005) 28 OSCB 7901.*

#### Introduction

This Policy establishes minimum standards for the development and implementation of branch and sub-branch review procedures. All references to “branch” in this Policy include sub-branches as defined in MFDA By-law No.1.

Members are responsible for establishing, implementing and maintaining policies and procedures to ensure that business is conducted and managed in accordance with MFDA By-laws, Rules and Policies and with applicable securities legislation. Under MFDA Policy 2, the Member is required to conduct an on-going review of sales compliance procedures and practices at both head office and at branch offices to confirm that these procedures are adequately fulfilling the purposes for which they have been designed. The requirement to complete regular branch reviews is consistent with these obligations and will serve to enhance the Member's ability to meet the fundamental supervision requirements under MFDA By-laws, Rules and Policies.

The intent of this Policy is to establish minimum standards for internal branch review programs (“Branch Review Program”), while allowing Members sufficient flexibility to develop procedures that are appropriate to the Member's size and business model. Accordingly, strict adherence to the minimum standards as set out in this Policy will not necessarily ensure that a Member's ~~Branch Review Program~~ is effective to ensure proper supervision and compliance with MFDA Rules. The objective is for Members to create and effectively implement processes that maximize their ability to detect potential compliance issues, so that corrective action may be taken before serious problems occur. MFDA staff will assess the effectiveness of the Member's ~~Branch Review Program~~ policy in the course of conducting compliance examinations and may impose additional requirements to ensure compliance with MFDA By-laws, Rules and Policies.

#### Branch Review ~~Policies and Procedures~~

Each Member must establish a Branch Review Program ~~procedures~~ to effectively assess and monitor compliance with regulatory requirements at all branch ~~and sub-branch~~ locations.

#### a) **General Requirements**

- The Branch Reviews Program must include an assessment of the supervisory procedures and practices in place at the branch, as well as the quality of execution of those procedures.
- The ~~Branch Review Program~~ must touch address on all significant ~~issues~~ aspects of that are addressed in the Member's policies and procedures manual and ~~in the~~ MFDA By-laws, Rules and Policies.
- The Branch Review Program ~~process~~ must include interviews with branch supervisors and a selection of other Approved Persons along with substantive testing to verify the accuracy of information that is provided in the interviews. Substantive testing should involve reviewing client files, trade blotters, trust account records, advertising and marketing material and other relevant records.

#### b) **Branch Interviews**

- The purpose of the interviews is to confirm that the branch manager and Approved Persons are aware of the requirements under MFDA By-laws, Rules and Policies and ~~other applicable~~ securities regulations. It is particularly important that the reviewer confirm that the branch manager has a good understanding of the fundamental supervisory requirements. The interview process also serves as a forum for the branch manager and Approved Persons to raise and discuss issues and areas of regulatory concern.

- The interviews must also include discussion about branch policies and procedures relating to:
  - products and services offered to clients;
  - complaints;
  - advertising and sales communications;
  - referral arrangements;
  - outside business activities;
  - account opening procedures; and
  - other branch and sub-branch supervision issues.

**c) Review of Trade Blotters and Other Supervisory Review Documentation**

- Documentation must be reviewed to confirm that trade reviews have been performed adequately and in a timely manner covering the minimum requirements of MFDA Policy 2. This includes a review to confirm that all trades in exempt securities and a sample of initial trades, leveraged transactions, trades made under a limited trading authorization or power of attorney, and trades in speculative funds have been reviewed. Samples of different types of transactions, including purchases, switches and redemptions must be reviewed. Trade blotters must be reviewed to assess:
  - trading patterns;
  - evidence of supervision; and
  - timeliness of review.
- The suitability of individual trades must be assessed to confirm that the quality of trade supervision is consistent with the Member's standards and regulatory expectations.
- Trade supervision records must also be reviewed to confirm the recording of issues noted by supervisory staff, inquiries made, responses received and resolutions achieved.

**d) Review of Client Files**

- Client files must be examined to verify that there is proper account opening documentation on file and that branch client files are appropriately safeguarded. Know-your-client information must be reviewed to:
  - assess completeness;
  - confirm that back up for any changes has been maintained on file; and
  - ~~confirm that branch client files are appropriately safeguarded; and~~
  - confirm that KYC information on the back office system matches with that recorded in the files.
- The branch review process must confirm that account opening approval procedures have been properly followed, where these are the responsibility of branch staff.
- Client files must be examined to verify that proper evidence of client instructions and any relevant trading authorizations have been maintained on file. Files should be reviewed to assess the adequacy of notes regarding advice or recommendations provided to the client, as well as notes regarding discussions relating to fees and services, if any.
- Trade orders must be reviewed to:
  - assess suitability;
  - detect unlicensed / out-of-province trading;
  - confirm proper identification of leveraged trades; and
  - confirm timeliness of trade processing.

**e) Review of ~~Client~~ Sales Communications, Advertising and Client Communications**

- The ~~branch~~ Review Program must include a review of sales communications, advertising and client communications, including ~~advertising~~, business cards, letterhead and websites to confirm that any required approvals have been obtained.
- The branch review process must also involve, where appropriate, discussions and testing to detect:
  - misleading communications;
  - ~~undisclosed use of Approved Person~~ trade names of Approved Persons that have not been approved by the Member;
  - undisclosed outside business activities or personal financial dealings with clients;
  - securities related business conducted outside of the Member; and

- undisclosed referral arrangements.
- Where the reviewer detects a potential material deficiency with respect to the conduct of outside business or personal financial dealings under MFDA By-laws, Rules or Policies, the ~~Branch~~ Review Program policy must provide ~~for the review of that files of Approved Persons relating to non-Member business must be reviewed.~~

**f) Complaints**

- The branch review process must confirm that any complaints that may have been made involving individuals at the branch have been recorded and handled in accordance with Member procedures and MFDA By-laws, Rules and Policies.
- The nature of any complaints, as well as the timeliness and fairness of resolution must be assessed.
- The branch review process must confirm that all complaints and pending legal actions are made known to the compliance officer at head office (or another person at head office designated to receive such information) within two business days in accordance with MFDA Policy No.3. ("Handling Client Complaints").

**Scope of Review**

Sample size and the extent of the review are matters of discretion for the Member. However, at a minimum, the review should involve a preliminary screening of the branch that is sufficient to provide a reasonable indication of items or issues for further investigation. Sample size and the extent of review must be reasonable based on a number of factors such as:

- \_\_\_\_\_-the specific activities at the branch;
- \_\_\_\_\_complaints history;
- \_\_\_\_\_ number of Approved Persons at the branch;
- \_\_\_\_\_trade volume/commissions earned;
- \_\_\_\_\_ results of previous reviews;
- \_\_\_\_\_ MFDA compliance examination findings;
- \_\_\_\_\_daily trade supervision issues;
- \_\_\_\_\_ experience of supervisory staff at the branch;
- \_\_\_\_\_ supervisory tools used at the branch (manual or automated);
- \_\_\_\_\_ the nature of dual occupations or outside business activities carried on at the branch;
- \_\_\_\_\_ the volume of leveraged trades; ~~and or~~
- \_\_\_\_\_-the date of the last review.

**Selection Criteria**

~~The branch review policy must include criteria for selection and prioritization of the branches. This may be based on a number of factors such as complaints history, trade volume, commissions earned, results of previous reviews, MFDA compliance examination findings, daily trade supervision issues, the nature of dual occupations or outside business activities carried on at the branch, the volume of leveraged trades or the date of the last review. In any case, the Member must be able to demonstrate that there is a rational method for branch selection in place that is reasonable for the Member's size and business model.~~

**Branch Review Cycle and Schedule**

The Member must be able to justify its branch review schedule and cycle by developing a risk-based methodology to rank branch and sub-branch locations as high, medium or low risk using appropriate criteria. Such criteria would include the factors set out above under "Scope of Review": ~~complaints history, trade volume, commissions earned, results of previous reviews, MFDA compliance examination findings, daily supervision issues, the nature of dual occupations or outside activities carried on~~

~~at the branch or the volume of leveraged trades. Members with a smaller number of branches and sub-branch locations are expected to perform a review of these locations annually. Where a Member has a significant number of branch and sub-branch locations and is able to justify a longer review cycle based upon their risk assessment, the review cycle can exceed one year but should not in any event exceed three years. Members are generally expected to perform an on-site review of their branches no less than once every three years. However, Members must review certain branches more frequently than once every three years if justified based on risk. Where, under unusual circumstances, a Member exceeds a three year branch review cycle, the Member must be able to justify the longer review cycle by demonstrating that the branches that have not been subject to an on-site review are low risk and have been subject to alternative compliance review procedures performed by head office, such as an off-site desk review. Under no circumstances however, should a Member never perform an on-site review of a branch.~~

The branch review cycle and the status of completion of the branch review cycle against benchmarks should be included as part of the annual compliance report to the board of directors or partners of the Member required by MFDA Rule 2.5.2(b).

### **Qualifications for Reviewers**

~~The individuals responsible for performing completing the branch reviews must have the training, skills and proficiency necessary to accomplish the objectives of the review program. The individuals must possess sufficient knowledge not only to be able to follow prescribed procedures, but to be able to know where follow up review should be pursued. In addition, Members should ensure that individuals delegated the responsibility to perform branch reviews have adequate existing time or whether workloads can be rescheduled in order to provide the time necessary for proper performance. Individuals that have two years of relevant industry experience or that have successfully completed the courses required for designation as a branch manager as set out under MFDA Rule 1.2.2(a) would generally be considered sufficiently qualified to perform branch reviews. Relevant industry experience would include formal audit experience or legal training in the area of securities and mutual fund regulation. Individuals that have successfully completed the courses required for designation as a branch manager as set out under MFDA Rule 1.2.2(a) or that have equivalent experience, training or education would generally be considered sufficiently qualified to perform branch reviews. The Member must consider the responsibilities and functions that are performed as part of a branch review and make the determination of what constitutes equivalent experience, training or education sufficient to qualify an individual as a branch reviewer. The Member will be required to satisfy the MFDA that the equivalency standard has been met.~~

Equivalent experience, training or education may include: audit experience, legal training in the area of securities or mutual fund regulation, or experience in a regulatory supervisory or compliance role. Members may also have an internal training program for branch reviewers, which may satisfy the equivalency test.

The branch reviewer must be independent of the branch and the branch manager, so as to ensure that the reviewer can act objectively without preconceived opinions and is not subject to inappropriate influence when performing the review.

### **Reporting of Results**

All serious issues detected in the branch reviews must be made known to the compliance officer at head office (or another person at head office designated to receive such information) within a reasonable period of time.

~~Each Member must also ensure that branch managers and Approved Persons are made aware of all issues that are identified in the branch review in a timely manner. In addition, Approved Persons at the branch should be made aware of issues identified in the report relevant to them.~~

The report to the branch manager on the results of the branch review must include the following information:

- the date of the review;
- basic branch information, including the Approved Persons and staff at the branch location;
- details of any compliance deficiencies noted in completing the branch review including missing documentation or any gaps in supervision;
- the date of the report; and
- the date by which a response is required.

### **Follow Up of Branch Review Findings**

The Member must have procedures in place ~~processes~~ to ensure that the issues identified in the course of the ~~internal examination-branch review~~ are followed up and resolved. Therefore, the ~~Branch Review Program process~~ must provide for:

- consistent and timely reporting of results;
- a means of tracking responses to the reports; and
- a means of ensuring that the branch implements all required changes in a reasonable amount of time.

**Branch Review Files**

Members must maintain orderly, up-to-date files for each branch that has been reviewed. The files must include details of the procedures performed at the branch and all working papers to support the work done and provide evidence of any deficiencies noted. All follow-up documentation, including the report to the branch manager, must also be included in the file. Records must be maintained for a period of seven years and must be made available for review by the MFDA, if requested.

Branch review records should be used to identify significant deficiencies that may disclose a need for further education and training of branch supervisors, Approved Persons, or other staff. When systemic issues are detected through the branch review process, a review of internal procedures and practices may be warranted.

**SUMMARY OF PUBLIC COMMENTS RESPECTING  
PROPOSED MFDA POLICY 5 – BRANCH REVIEW REQUIREMENTS  
AND RESPONSE OF THE MFDA**

On September 23, 2005, the Ontario Securities Commission published for public comment MFDA Proposed Policy 5 – Branch Review Requirements (the “Proposed Policy”). The MFDA proposal was published in Volume 28, Issue 38 of the Ontario Securities Commission Bulletin, dated September 23, 2005.

The public comment period expired on October 23, 2005.

Six submissions were received during the public comment period:

1. Canadian Bankers Association (“CBA”)
2. Family Wealth Advisors Ltd. (“FWA”)
3. PFSL Investments Canada Ltd. (“PFSL”)
4. IGM Financial Inc. (“IGM”)
5. The Investment Funds Institute of Canada (“IFIC”)
6. BMO Investments Inc. (“BMO”)

Copies of comment submissions may be viewed at the offices of the MFDA, 121 King Street West, Suite 1600, Toronto, Ontario by contacting Laurie Gillett, Manager, Communications and Membership Services Manager, (416) 943-5827.

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

**1. General Comments**

**Need for Flexibility**

In general, commentators were supportive of the initiative to establish minimum standards for branch review procedures; however, various commentators had comments with respect to particular sections of the Proposed Policy.

Several commentators expressed the view that the Proposed Policy imposed branch review standards that were not flexible enough to accommodate specific compliance needs of Members, in light of differences in size and business model represented by the MFDA membership.

IGM suggested that the framework for branch reviews should take the differences in size of Members into account. IGM noted that it may be necessary, for example, to review a larger percentage of transactions at a small branch to obtain a meaningful sample than at a larger one.

PFSL was of the opinion that the Proposed Policy required clarification with respect to how much flexibility Members would be allowed in fulfilling the minimum standards prescribed by the Proposed Policy and whether all of the review activities listed must occur in each branch visit. This commentator was of the opinion that a mandate of a branch review encompassing all of the requirements stated in the Proposed Policy would be an unnecessary financial and logistical burden to many Members and would not necessarily increase the effectiveness of the Member’s compliance function. PFSL stated that Members should be permitted to develop their own programs through a field audit program, head office monitoring activities, other compliance activities or combination thereof. The commentator described some of its own compliance processes (which exist in addition to the Member’s field audit branch review program) in detail in order to demonstrate that the objectives of the Proposed Policy may be met without a physical branch visit but rather through head office systems.

**MFDA Response**

MFDA Policies are intended to establish minimum industry standards but also permit alternative approaches to compliance where the Member can justify them. However, not performing on-site branch reviews is unacceptable. Accordingly, branches must be subject to an on-site examination regardless of the Member’s Head Office compliance process. Certain types of deficiencies and compliance issues can only be detected through on-site reviews. A strong centralized Head Office compliance process may reduce the frequency of on-site branch reviews but not eliminate the need to perform them.

### **Consistency between Self-Regulatory Organizations**

IGM and IFIC were of the view that, to the extent possible, the requirements of the Proposed Policy should be broadly consistent with those of the Investment Dealers Association of Canada ("IDA"). These commentators noted that since many MFDA Members have dealers that are affiliated with IDA, it would be logical and desirable for a single set of branch review requirements to be mandated by both the MFDA and IDA. Self-regulatory organizations requirements should be harmonized except where differences in business models justify different treatment.

IFIC noted, for example, that the IDA does not have minimum review cycle standards for branch locations even though one would expect that IDA Members conduct higher risk activities than MFDA Members.

#### **MFDA Response**

The IDA does not currently have a formal policy that prescribes particular standards for branch review programs. On a more general level, IDA By-law 29.27(a) does require its Members to establish and maintain a supervisory system that includes periodic on-site reviews of branch office supervision and requires that proper records to be maintained with respect to such reviews. MFDA Policy 2 generally requires Members to conduct an on-going review of sales compliance procedures and practices both at head office and at branch offices to ensure that adequate supervision is being completed.

Through compliance examinations of Members, MFDA staff has observed that some Members have not implemented branch review procedures that are sufficient to meet their supervisory obligations. The proposed Policy was developed to give Members more detailed guidance on complying with their obligations with respect to branch supervision. MFDA staff is of the view that it is beneficial to Members to set out minimum standards for branch review procedures in a Policy rather than conveying our expectations through compliance reviews of Members.

### **Training for Branch Managers**

FWA was of the view that the MFDA should improve the services it provides to branch managers/dealers. FWA submitted that the MFDA should provide training to branch managers to enable them to detect and deal with issues that relate to safeguarding the public. The MFDA should provide information and case studies on how situations that lead to enforcement actions were uncovered.

#### **MFDA Response**

The MFDA Member Regulation Forum, which is held semi-annually, provides compliance staff and supervisory personnel of Members with information and guidance with respect to compliance with MFDA requirements. As part of the Member Regulation Forum, we will also consider offering a training session specifically for branch managers. Further, the MFDA also issues numerous Member Regulation Notices and bulletins on supervisory issues that discuss how to detect and prevent non-compliance. Training provided to branch managers must be specific to the Member's operations, which requires that the Member tailor the training of supervisory staff to its circumstances.

## **2. Branch Selection Criteria**

IGM expressed the opinion that the MFDA should provide more specific guidance with respect to the relative weighting of criteria set out in the Policy for selection and prioritization of the branches that should be reviewed. IGM also suggested that it would be useful for the MFDA to share the basic elements and weightings of the risk model it uses to select branches of Members for review.

In addition, IGM commented that the interaction between the branch selection process and the branch review process is not entirely clear in the Proposed Policy. The criteria used in the branch review cycle process are used to identify a particular branch as high, medium or low risk, while the criteria used in the branch selection process are used to identify specific branches for review. As these criteria overlap but vary, the commentator was of the view that additional commentary should be added to the Proposed Policy with respect to the way the selection criteria interrelate for these two purposes.

#### **MFDA Response**

The section in proposed Policy 5 on branch selection criteria has been deleted. The criteria set out under this section are already addressed under the branch review cycle and are therefore redundant. With respect to the suggestion of the commentator that the Policy provide more guidance regarding the relative weighting of criteria, the MFDA is of the view that Members should determine their own weighting that reflects the risk at each branch.

### **3. Branch Review Cycle**

#### **More Flexible Approach Required**

Four commentators expressed concern with the requirements set out in Policy 5 regarding the frequency of branch reviews. The CBA and BMO noted that unlike other mutual fund dealers, bank mutual fund dealers operate many branches in small and remote localities, often with a relatively small number of clients. It was submitted that requiring on-site reviews of all branches and sub-branches once every three years, without regard to risk, would require the bank mutual fund dealers to make significant additions to compliance staffing and budgets which will necessarily translate into increased costs for customers. The CBA and BMO were of the view that increasing compliance costs could make the servicing of small accounts and the maintenance of small branches in small and remote localities uneconomic for those firms (predominantly bank mutual fund dealers) that continue to serve this market segment.

IFIC expressed concern that the implementation of the proposed three-year review requirement would significantly increase the costs and staffing needs required to conduct branch reviews. IFIC and BMO submitted that low trade volumes and remote locations of many smaller branches will make the three-year review requirement difficult and expensive to comply with.

The CBA, IFIC and BMO submitted that a more flexible approach to frequency of reviews and permitting Members to decide when an on-site review is appropriate would be preferable. These commentators were of the view that the frequency of branch reviews should be left to the judgment of the Member based on the risk profile of the branch. The CBA, IFIC and BMO were of the view that the Policy should afford firms greater flexibility in determining when alternative methods of conducting reviews, such as off-site branch desk reviews, are appropriate.

#### **MFDA Response**

We have considered the comments and have amended the Policy to provide some additional flexibility with respect to the branch review cycle. As set out in the amended Policy, Members must be able to justify their branch review cycle and schedule by developing a risk-based methodology to rank branch and sub-branch locations as high, medium or low risk using appropriate criteria. Members are generally expected to review their branches and sub-branches no less than once every three years. However, Members must review certain branches and sub-branches more frequently than once every three years if justified based on risk. Where, under unusual circumstances, a Member exceeds the review cycle set out in the Policy, the Member must be able to justify the longer review cycle by demonstrating that the branches that have not been subject to on-site review are low risk and have been subject to alternative compliance review procedures performed by head office, such as an off-site desk review. Under no circumstances however should a Member never visit a branch location. There should be a review cycle for all branch and sub-branch locations. The Policy has been amended to reflect this position.

#### **More Guidance Required**

IGM and IFIC submitted that the Proposed Policy provided limited guidance with respect to developing a risk-based approach to identifying particular branches as high, medium or low risk. In particular, IGM commented that the Policy provides risk-ranking criteria but does not give any guidance as to the relative weighting to be given to the criteria. IFIC stated that the risk-based criteria in the Policy are vague and therefore, if standards are not mandated, there will be inconsistent application of the Policy among different MFDA Members. IFIC suggested that the MFDA clarify and give guidance to Members on the factors that should be included in risk-based methodology when selecting branches to review.

#### **MFDA Response**

As stated above, the MFDA is of the view that Members should determine their own weighting for the criteria listed in the Proposed Policy that reflects the risk at each branch.

#### **Annual Review Requirement for Smaller Dealers**

FWA expressed concern with the costs associated with annual branch reviews for smaller dealers versus larger dealers that must only review their branches once every three years. This commentator expressed the view that these costs will ultimately take time away from servicing clients.

FWA suggested that it may be more appropriate for smaller branches to have fewer audits/reviews assuming there is no history of compliance issues. In smaller branches, the branch manager has a more intimate relationship with advisers under his or her supervision. This factor, combined with an appropriate infrastructure to review trades and periodic meetings with advisers should result in a manager of a smaller branch detecting compliance issues earlier.

FWA submitted that a three-year audit cycle is more equitable for smaller dealers. The commentator suggested that the frequency of reviews could be increased if serious deficiencies are identified.



**MFDA Response**

As noted above, the Policy has been amended to remove the distinction made in the previous draft based on the size of dealership. Each Member is expected to develop an appropriate branch review cycle and schedule based on risk in accordance with the expectations set out in the amended Policy.

**4. Qualifications for Reviewers**

**Requirements are too Prescriptive**

The CBA was of the view that the requirements regarding the qualifications for reviewers are inappropriately prescriptive and should be revised. The CBA submitted that it is inappropriate for a Policy to effectively prescribe minimum qualifications for review staff, analogous to registration requirements, and that the obligation of Members to establish, implement and maintain policies and procedures is sufficient. IFIC submitted that requiring specific proficiency for a branch reviewer is essentially the imposition of a branch manager registration requirement and should be mandated by a Rule amendment rather than through Policies.

IGM commented that the proficiency and education requirements for reviewers prescribed by the Proposed Policy were too rigid and, consequently, may limit the pool of available personnel by eliminating reviewers who may have the necessary ability but lack the prescribed designation or length of experience.

**MFDA Response**

The Policy outlines what the MFDA believes are minimum requirements for examination staff. The overall objective is to ensure that the individuals responsible for completing the branch reviews have the training, skills and proficiency necessary to accomplish the objectives of the review program.

After considering the comments, the MFDA is of the view that the Policy should be amended to provide some flexibility to recognize alternative but equivalent experience, training or education (other than completion of the branch manager course). Accordingly, the revised Policy has been amended to require that the branch reviewer must either have completed the branch manager course or have a combination of equivalent experience, training or education. The Member must consider the responsibilities and functions that are performed as part of a branch review and make the determination of what constitutes equivalent experience, training or education sufficient to qualify an individual as a branch reviewer. The Member will be required to satisfy the MFDA that the equivalency standard has been met.

Equivalent experience, training or education may include: audit experience, legal training in the area of securities or mutual fund regulation, or experience in a regulatory supervisory or compliance role. The Member may also have an internal training program for branch reviewers, which may satisfy the equivalency test.

**Meaning of Relevant Industry Experience**

PFSL expressed the opinion that the definition of "relevant experience" under the Proposed Policy ("formal audit experience or legal training") was overly restrictive and that appropriate industry experience, in the good judgment of the Member, would also meet the objectives of the Policy.

IGM was of the view that the Proposed Policy should provide more guidance with respect to what constitutes "relevant experience". IFIC submitted that the term "relevant" is ambiguous and requested further clarification.

**MFDA Response**

The Policy has been amended as outlined above.

**Requirement for Independence**

FWA noted that in a smaller dealership, it is likely that one branch manager will be required to review the branch of another branch manager to achieve the independence and objectivity of the process. It was suggested that such annual reviews would detract from the branch manager's time to oversee his/her own branch.

**MFDA Response**

It is the responsibility of the Member to ensure that it has adequate resources to comply with the requirements of the Policy as well as other supervisory responsibilities.

## **5. Branch Review Policies and Procedures**

### **Review of Client Files**

PFSL noted that the requirement in Policy 5 to review client files at the branch to confirm that Know-Your-Client (“KYC”) information on the back office system matches with that recorded in the files, would be duplicative and burdensome for Members that have a head office process where KYC information is screened before a trade is processed, and where the KYC information is entered into the back office system by Member head office processors.

### **MFDA Response**

The issue is one of completeness and accuracy. Members using such a process are only aware of what is sent in to them by the Approved Person. MFDA has found, in Members using such a process, that there are New Account Application Forms on file that do not match what has been sent to head office and are being used for supervisory trade reviews. Accordingly, such a procedure is not time consuming and should be performed.

### **Review of Trades**

IGM submitted that, unlike IDA requirements, MFDA policies, including the Proposed Policy, do not provide sufficient guidance with respect to what trades should be reviewed (for example, based on commission levels). IGM was of the view that this gap leads to difficulties in the context of an effective branch review program in that it is not entirely clear as to what trades should be reviewed in the ordinary course at the branch level.

### **MFDA Response**

The MFDA will consider the appropriateness of providing additional guidance through amendments to MFDA Policy 2 (Minimum Standards for Account Supervision).

### **Review of Client Communications**

IGM expressed concern with the provision in the Policy, which states that where the reviewer detects a potential material deficiency with respect to the conduct of outside business or personal financial dealings under MFDA Rules, the branch review program must provide that files of Approved Persons relating to non-Member business must be reviewed. In IGM’s view, such a requirement could raise confidentiality and privacy concerns in situations where other individuals involved in that business activity may not have consented to having their information shared with the Member. IGM felt that this requirement is unenforceable and could be deleted without compromising the obligation of Members to monitor outside business activities of Approved Persons.

### **MFDA Response**

Members have supervisory obligations with respect to outside business activities of their Approved Persons. To the extent that such activity raises concerns with respect to compliance with MFDA Rules, the Member must have access to the files of the Approved Person to conduct an investigation. How such access is obtained is a matter for the Member to determine. For example, the Member may, as part of the process for approving the outside business activity, ensure that the consent of any relevant individual to disclosure is obtained.

### **Interviews with Approved Persons**

IGM was of the view that the Proposed Policy does not provide sufficient guidance as to the number of interviews that should be conducted during a branch review and suggested that the Proposed Policy should either provide more precise guidance in this respect, or expressly indicate that this issue is left to the discretion of the Member.

### **MFDA Response**

The Policy generally requires that the branch review process include an interview with the branch manager and Approved Persons at the branch. The decision as to how many Approved Persons at the branch should be interviewed is up to the discretion of the Member and should be based on risk assessment. The Policy has been amended to clarify the requirement that a selection of Approved Persons at the branch be interviewed rather than all Approved Persons at the branch.

### **Sample Size**

IGM felt that it was appropriate that the determination of sample size for substantive testing be left to the discretion of the Member. However, IGM suggested that the Proposed Policy should provide guidance as to what level of sampling would be appropriate.

### **MFDA Response**

The Policy requires that Member select a sample that is reasonable based on a number of factors such as: specific activities at the branch, complaints history, trade volume, commissions earned, results of previous reviews, MFDA compliance examination findings, daily trade supervision issues, the nature of dual occupations or outside business activities carried on at the branch, the volume of leveraged trades or the date of the last review. The level of sampling will depend on these factors.

### **6. Reporting of Results**

PFSL expressed the opinion that the requirement to make branch managers and Approved Persons aware of all issues that are identified in the branch review is inappropriate. According to this commentator, this requirement would have troublesome implications with respect to confidentiality and privacy of certain information, create dealer exposure and raise proprietary business issues. The commentator also questioned the necessity for Approved Persons to be given information about their branch manager. PFSL submitted that such information would be best shared with the branch manager, his or her supervisors, and with head office staff, and appropriate corrective action with respect to such information would be the responsibility of each of these parties.

### **MFDA Response**

A copy of the branch report does not need to be provided to all Approved Persons at the branch. The branch review report should be provided to the branch manager and to any of his or her superiors. Approved Persons at the branch should be advised of issues of non-compliance identified in the report relating to them and should be informed of the Member's requirements to resolve non-compliance at the branch. The Policy has been amended to clarify this issue.

### **7. Cost/Benefit Considerations**

The CBA submitted that the MFDA, prior to increasing the frequency of reviews and requiring on-site reviews, should determine whether the current system has shortcomings and determine what information is not being caught. The CBA was of the view that prior to implementing new requirements that will result in increased costs, the MFDA should assess whether the benefits are likely to be justified by these costs.

FWA felt that the MFDA should be accountable to the industry for the results of Policy 5. It was suggested that three years after implementation, a public report should be issued outlining the costs to the industry and public resulting from Policy 5. The number of serious issues detected and dealt with under the Policy versus the state of compliance in place before should be addressed and compared to results from the IDA.

### **MFDA Response**

MFDA staff have observed that many Members have not implemented branch review procedures that are sufficient to discharge their supervisory obligations. In particular, many Members are not performing on-site reviews and are unaware of certain activities occurring at their branches that could have otherwise been detected through such reviews. As the instances of non-compliance at Member branches are significant, the public interest necessitates Members taking a more active role in assessing branch compliance. It was for this reason that the MFDA developed a Policy to provide Members with guidance regarding the MFDA's minimum expectation for branch reviews.