

13.1.4 Proposed Amendments to MFDA Rule 2.2 (Client Accounts) and MFDA Policy No. 2 Minimum Standards for Account Supervision

MUTUAL FUND DEALERS ASSOCIATION OF CANADA
PROPOSED AMENDMENTS TO MFDA RULE 2.2 (CLIENT ACCOUNTS)
AND
MFDA POLICY NO. 2
MINIMUM STANDARDS FOR ACCOUNT SUPERVISION

I. OVERVIEW

A. Current Rules

MFDA Rule 2.2 addresses the basic business conduct and client record requirements that Members must satisfy with respect to client accounts maintained by the Member. The current Rule prescribes:

- the requirement to collect know-your-client ("KYC") information when an account is opened;
- the requirement to ensure that recommendations made for the client's account are suitable;
- the requirement to complete a new account application form for each account;
- the requirement that each account be approved by a designated individual; and
- the requirement to document material updates to KYC information.

MFDA Policy No. 2 establishes minimum industry standards for supervision of client accounts and expands upon the basic requirements contained in Rule 2. Policy No. 2 provides guidance with respect to account opening documentation to be maintained and supervisory procedures to be completed at the branch and head office levels.

B. The Issues

Since September 2004, staff of the MFDA, the Investment Dealers Association of Canada ("IDA") and the Canadian Securities Administrators ("CSA") have been involved in working groups focused on the implementation of various aspects of the Client Relationship Model ("CRM"). One of the core principles addressed in CRM focuses on the need for clear definition of the relationship between the client and the financial services provider and the roles and responsibilities that each party will assume when an investment account is opened. Clients must be provided with adequate information regarding the client/dealer relationship at the time the relationship is established in order to understand the basic obligations of their dealer and what to expect as far as service levels.

The working groups involved in the CRM project also examined the issue of dealer responsibilities in ensuring that a client's investments remain consistent with the client's needs and objectives. In light of the investor protection issues involved, the MFDA supports the position that a regulatory response to this issue is necessary.

While current MFDA Rules and Policies address some aspects of the regulatory objectives of the CRM project, amendments are required to more fully respond to the concerns that have been raised.

In addition, the MFDA has also become aware of a number of other issues with respect to procedures employed by some Members in discharging their supervisory duties in connection with their clients' accounts. As some of the changes to be implemented under CRM relate to issues of supervision and involve the same Rules and Policies, these changes are being brought forward with the CRM proposal.

C. Objectives

As noted above, one of the main objectives of the proposed amendments is to clarify for clients the nature of the client/advisor relationship and, in some respects, expand the disclosure to be provided to clients on account opening.

Proposed amendments to the existing suitability requirements are designed to help ensure that client accounts are reviewed at relevant times and remain consistent with the client's needs and objectives.

The proposed amendments are also intended to clarify procedures that Members and Approved Persons must follow in order to satisfy their obligations regarding the collection and maintenance of KYC information and their obligations with respect to investment suitability and account supervision.

D. Effect of Proposed Amendments

Amendments to Rule 2.2 have been proposed to require that investors be provided with certain fundamental information at the time that an account is opened. This will help to ensure that clients are aware of the role and responsibilities of the Member and what to expect as far as services and costs. While some Members may already provide such information to clients as part of their business processes, the proposed amendments would effectively set a new minimum standard of relationship disclosure for clients of all Members.

Amendments to Rule 2.2 have also been proposed to clarify the duty of Members and Approved Persons to assess the suitability of investments in each client account when various triggering events occur.

Amendments to Policy No. 2 have been proposed to clarify the responsibilities of Members and Approved Persons in discharging their suitability obligations. These changes address issues regarding the KYC information that must be collected for each client, the maintenance of information on file and minimum standards that must be observed with respect to account supervision procedures. Some Members may be required to amend their current procedures to meet the new requirements.

It is not expected that the proposed amendments will have other significant effects on Members, other market participants, market structure or competition. Some aspects of the proposed amendments will result in additional systems, operational and compliance costs for Members. The extent of these costs will depend on the existing systems in place at the particular Member.

II. DETAILED ANALYSIS

A. Relevant History

In February 2000, the Ontario Securities Commission ("OSC") established the Fair Dealing Model Committee. The findings of this committee were summarized in the OSC's Fair Dealing Model Concept Paper which was published in January, 2004. The Fair Dealing Model Concept Paper also set forth a number of proposals for regulatory reform, touching on many aspects of the client/advisor relationship.

Certain issues raised in the Fair Dealing Model Concept Paper were carried forward under the CRM project, which, as noted above, involved staff of the MFDA, IDA and the CSA. The three core principles that the CRM project seeks to address are:

- clarity of the client/firm relationship;
- performance reporting; and
- cost, compensation and conflicts disclosure.

MFDA staff has conducted numerous consultations on various proposals to address the CRM project's objectives. These were conducted through the MFDA Member Regulation Forums, the MFDA Policy Advisory Committee and other ad hoc industry meetings. Alternative viewpoints and suggestions from Members, regulators and other industry participants were discussed at length in these consultations and the input received by staff has been factored into the proposed amendments that are now being published for comment.

The possibility of conducting a cost/benefit analysis of changes proposed in relation to the CRM project was also discussed. However, no agreement with potential participants was reached regarding the approach to be followed in conducting the analysis. Many of the proposed amendments, however, were developed in part to address regulatory concerns that have been identified through the MFDA's compliance and enforcement activities. Further, the proposed amendments have been developed with the intent of achieving the investor protection objectives of the CRM project while taking into consideration existing operational systems.

While there is some degree of overlap between each of these issues, the core principles were to a large extent considered discreetly. For the purpose of clarity, the resulting proposed changes to the Rules and Policies that relate to each issue are being published for comment separately as well.

In the course of completing compliance reviews and in investigating enforcement cases, MFDA staff has identified certain investor protection concerns regarding suitability and account supervision issues. MFDA staff has also received comments from Members requesting clarification of other aspects of the supervisory requirements under MFDA Rule 2 and Policy No. 2. As

these issues relate to similar concerns raised under the CRM project and involve the same Rules and Policies, proposed changes to address these additional issues are being brought forward with the amendments relating to the CRM project.

B. Proposed Amendments

Proposed amendments to Rule 2 include new subsection 2.2.5 which will require that, on account opening, all clients are provided with certain core information about the nature of their relationship with the Member and its Approved Persons. The information will address fundamental questions and clarify certain key concepts that are at the root of many complaints MFDA staff has observed. The proposed changes are designed to:

- clarify the activities for which the Member is responsible;
- ensure that clients are aware of the suitability obligations of the Member and Approved Person;
- clarify the account reporting that clients will receive; and
- ensure that clients are provided with a general understanding of how the Member is compensated.

The proposed amendments also require that the suitability of the investments held in each client's account be assessed when certain triggering events occur. Amendments to Rule 2.2.1 will require that the suitability of investments in each client account be assessed whenever:

- the client transfers assets into an account at the Member; or
- the Member or Approved Person becomes aware of a material change to the client's KYC information.

Approved Persons will also be expected to review the suitability of investments in any account where the account has been re-assigned to the Approved Person from another registered salesperson within the Member firm.

Amendments have also been made to Rule 2.2.4 regarding the updating of client KYC information, providing greater detail as to the client authorization, verification and approval requirements for such changes.

Other minor amendments have been made to clarify the current language and intent of Rule 2.2 to ensure the amended Rule is consistent with other Rules and Policies to be amended.

The proposed amendments to MFDA Rule 2.2 are noted in Schedule "A" to this notice.

A number of amendments with respect to Policy No. 2 have been proposed, including amendments to:

- clarify proficiency requirements for individuals that perform delegated tasks;
- clarify the information that must be collected at the time an account is opened;
- clarify when new account application forms must be completed and approved;
- clarify requirements relating to the updating of client information and the approval of material changes;
- clarify standards to be followed regarding the assessment of investment suitability and suitability of leverage;
- prescribe minimum supervisory procedures and trade thresholds for daily account supervision at the branch and head office levels; and
- require Members to perform reviews to identify trends in trading activity and other issues.

As some of these changes may require system changes for Members, the MFDA seeks comments with respect to reasonable transition periods that would be required to develop and implement such systems changes.

Other minor additional amendments have been made to clarify the current language and intent of Policy No. 2.

The proposed amendments to MFDA Policy No. 2 are noted in Schedule "B" to this notice.

C. Issues and Alternatives Considered

As noted above, several alternative approaches to address the issue of relationship disclosure were examined and discussed by the CRM project working group. In addition, a number of practical considerations were brought to the attention of MFDA staff through the consultation sessions with industry participants. For example, previous draft proposals contained a number of additional prescribed disclosure requirements. However, a number of commenters raised concerns that the prescribed disclosure was duplicative of existing requirements under securities legislation, other MFDA Rules or other ongoing regulatory initiatives. The MFDA responded to industry concerns by streamlining the proposal and adopting a more principle-based approach, so that the regulatory objectives can be achieved while still maintaining some degree of flexibility for compliance. Some of the duplicative content requirements that have been eliminated include:

- the requirement to disclose conflicts of interest;
- the requirement to provide a list of account documents to be provided on account opening;
- the requirement to disclose service fees; and
- the requirement to disclose contact information, the existence of dispute resolution services and the requirement to provide complaint handling information.

Rather than require that a specific relationship disclosure document be provided to clients, as considered in previous draft proposals, the amendments currently proposed by the MFDA allow for disclosure to be provided to clients in one document or several, as long as the information is provided at account opening.

Changes to the current suitability requirements were proposed as a solution to a perceived regulatory gap in investment risk reporting identified by CSA staff. Suggestions were made that the risk level of investments held in each client's account should be reported on a regular basis to allow investors the opportunity to review this information in light of their risk tolerance. The underlying investor protection issue to be addressed through risk disclosure centres on the potential disparity between portfolio risk versus client risk tolerance. The proposed amendments address this issue, but avoid the costs and uncertainties that would have been introduced under a mandatory risk reporting regime.

The issue of risk and fee disclosure was also considered in light of the Joint Forum of Financial Market Regulators proposed Framework 81-406 (the "Point of Sale Project"). As the Point of Sale Project will require dealers to provide clients with standardized disclosure addressing the issues of risk and fees at the time of each transaction, when information on these points is most relevant, general disclosure relating to risks and costs on account opening is sufficient and appropriate.

With respect to the trade threshold criteria contained in the amendments to Policy No. 2, MFDA staff reviewed the policies and procedures currently in place at Member firms before setting the minimum thresholds proposed under the Policy. Based on information obtained from compliance examinations completed to date, more than 80% of Members have policies and procedures in place that are in compliance with either the proposed branch trade review thresholds or the proposed head office trade review thresholds.

D. Comparison with Similar Provisions

The Financial Services Authority (the "FSA") in the United Kingdom currently requires registered firms to provide all clients with information regarding the firm and the services it provides before any such services are provided to the client (New Conduct of Business Sourcebook – Section 2.2). The disclosure addresses products and services that may be offered, costs, complaint information and coverage under the UK Financial Services Compensation Scheme. The FSA has produced template forms for firms to follow in providing this disclosure.

IDA Policy 2 was reviewed as part of the process followed in making the proposed changes to MFDA Policy No. 2. Many of the amendments have been proposed to reflect the current provisions of the IDA Policy or more recent changes that are awaiting approval. Different approaches have been taken where warranted due to differences between the business operations of investment dealers and mutual fund dealers.

E. Systems Impact of Amendments

Because system changes may be required to comply with some of the proposed amendments, the MFDA will consider transition periods for the implementation of the amendments to Rule 2 and Policy No. 2 to ensure that Members are provided with sufficient time to comply with the new requirements. Members will also be expected to create processes to ensure that existing accounts comply with the new requirements. **Comments and suggestions are sought to assist in determining reasonable transition periods to allow for revisions to existing documentation and systems changes.**

F. Best Interests of the Capital Markets

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

G. Public Interest Objective

The proposed amendments will assist in the protection of investors by ensuring that investors receive an adequate level of information regarding the relationship they enter into with the Member when opening an account and ensuring that client accounts are properly supervised on an ongoing basis.

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 2.2
MFDA Policy No. 2
IDA Policy 2
FSA – New Conduct of Business Sourcebook – Section 2.2

V. REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 90 days of the publication of this notice, addressed to the attention of 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 Corrigan-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.

Questions may be referred to:

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

SCHEDULE A

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

CLIENT ACCOUNTS (Rule 2.2)

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 2.2:

2.2 CLIENT ACCOUNTS

2.2.1 **"Know-Your-Client"**. Each Member and Approved Person shall use due diligence:

- (a) to learn the essential facts, as may be prescribed by the Corporation from time to time, relative to each client and to each order or account accepted;
- (b) to ensure that the acceptance of any order for any account is within the bounds of good business practice; ~~and~~
- (c) to ensure that each order accepted or recommendation made for any account of a client is suitable for the client ~~and in keeping with the client's investment objectives; and~~ based on the essential facts relative to the client and any investments within the account;
- (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client based on the essential facts relative to the client and the investments in the account, ~~and in keeping with the client's investment objectives~~, the Member or Approved Person has so advised the client before execution thereof; ~~and the Member or Approved Person has maintained evidence of such advice;~~
- (e) to ensure that the suitability of the investments within each client's account is assessed:
 - (i) whenever the client transfers assets into an account at the Member;
 - (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
 - (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member; and
- (f) to ensure that, where investments in a client's account are determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address any inconsistencies between investments in the account and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations.

2.2.2 **New Accounts Application Form.**

- (a) Each new account for a client must be opened by the Member within a reasonable time of the client's instruction to do so. Account numbers must not be assigned unless they are accompanied by the proper name and address for the client.
- (b) A New Account Application Form must be completed for each new account of a client. If the New Account Application Form does not include know-your-client information, this must be documented on a separate Know-Your-Client form. Such form or forms shall be duly completed to conform with the requirements of Rule 2.2.1 and shall be signed by the client and dated. ~~Account numbers must not be assigned unless they are accompanied by the proper name and address for the client and such name and address must be supported by the New Account Application Form.~~

2.2.3 **New Account Approval.** Each Member shall designate a trading partner, director or officer or, in the case of a branch office, a branch manager reporting directly to the designated partner, director or officer, who shall be responsible for approval of the opening of new accounts and the supervision of account activity. The designated person shall ~~promptly after the completion of any initial transaction specifically~~ approve the opening of such account in writing and a record of such approval shall be maintained in accordance with Rule 5.

2.2.4 **Updating ~~Know-Your-Client~~ Information**

- (a) Definition. In this Rule, “**material change in client information**” means any information that could reasonably result in changes 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.
- ~~(a)(b)~~ The Form documenting know-your-client information must be updated to include any material change in client information whenever a Member or Approved Person or other employee or agent becomes aware of such change including pursuant to Rule 2.2.4~~(b)~~.
- (c) Subject to paragraph (d), the Member must maintain evidence of client instructions regarding any material changes in client information and all such changes must be approved by the individual designated in accordance with Rule 2.2.3 as responsible for the approval of the opening of new accounts.
- (d) A client signature must be obtained to evidence any change in client name, client address or client banking information.
- ~~(b)(e)~~ Without reducing the responsibility of Members in Rule 2.2.1, all Members must at least annually, in writing, request each client to notify the Member if there has been any material change in ~~know-your-client~~ information previously provided to the Member or the client’s circumstances have materially changed. The date of such request and the date upon which any such client information is received and recorded or amended must be retained.
- ~~(c)~~ Written authorization must be obtained from the client for any change in a client name.

2.2.5 **Relationship Disclosure.** For each new account opened, the Member shall provide written disclosure to the client:

- (a) describing the nature of the advisory relationship;
- (b) describing the products and services offered by the Member;
- (c) describing the Member’s 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;
- (d) describing the Member’s obligation to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and advising when the Member will assess the suitability of the investments in the client’s account;
- (e) defining the various terms with respect to the know-your-client information collected by the Member and describing how this information will be used in assessing investments in the account;
- (f) describing the content and frequency of reporting for the account; and
- (g) describing the nature of the compensation that may be paid to the Member and referring the client to other sources for more specific information.

SCHEDULE B

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

MINIMUM STANDARDS FOR ACCOUNT SUPERVISION (Policy No. 2)

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Policy No. 2:

MFDA POLICY NO. 2

MINIMUM STANDARDS FOR ACCOUNT SUPERVISION

Introduction

This Policy establishes minimum industry standards for account supervision. These standards represent the minimum requirements necessary to ensure that a Member has procedures in place to properly supervise account activity. This Policy does not:

- (a) relieve Members from complying with specific MFDA By-laws, Rules and Policies and securities legislation applicable to particular trades or accounts; or
- (b) preclude Members from establishing a higher standard of supervision, and in certain situations a higher standard may be necessary to ensure proper supervision.

To ensure that a Member has met all applicable standards, Members are required to know and comply with MFDA By-laws, Rules and Policies as well as applicable securities legislation which may apply in any given circumstance. The following principles have been used to develop these minimum standards:

- (a) The term "review" in this Policy has been used to mean a preliminary screening designed to detect items for further investigation or an examination of unusual trading activity or both. It does not mean that every trade must be reviewed. The reviewer must use reasonable judgement in selecting the items for further investigation.
- (b) It has been assumed that Members have or will provide the necessary resources and qualified supervisors to meet these standards.
- (c) The initial compliance with the know-your-client rule and suitability of investment requirements is primarily the responsibility of the registered salesperson. The supervisory standards in this Policy relating to know-your-client and suitability are intended to provide supervisors with a checklist against which to monitor the handling of these responsibilities by the registered salesperson.

Members that seek to adopt policies and procedures relating to branch and head office supervision or the allocation of supervisory activities that differ from those contained in this Policy must demonstrate that all of the principles and objectives and minimum standards set out in this Policy have been properly satisfied. Further, any such alternative policies and procedures must adequately address the risk management issues of the Member and must be pre-approved by MFDA staff before implementation.

I. ESTABLISHING AND MAINTAINING PROCEDURES

Effective self-regulation begins with the Member establishing and maintaining a supervisory environment which both fosters the business objectives of the Member and maintains the self-regulatory process. To that end a Member must establish and maintain procedures which are supervised by qualified individuals. A major aspect of self-regulation is the ongoing education of staff in all areas of sales compliance.

Establishing Procedures

- 1. Members must appoint designated individuals who have the necessary knowledge of industry regulations and Member policies to properly perform the duties.
- 2. Written policies must be established to document supervision requirements.

3. Written instructions must be supplied to all supervisors and alternates to advise them on what is expected of them.
4. All policies established or amended should have senior management approval.

Maintaining Procedures

1. Evidence of supervisory reviews must be maintained. Evidence of the review, such as inquiries made, replies received, date of completion etc. must be maintained for seven years and on-site for one year.
2. An on-going review of sales compliance procedures and practices must be undertaken both at head office and at branch offices.

Delegation of Procedures

1. Tasks and procedures may be delegated to a knowledgeable and qualified individual but not responsibility.
2. The Member must advise supervisors of those specific functions which cannot be delegated, such as approval of new accounts.
3. The supervisor delegating the task must ensure that these tasks are being performed adequately and that exceptions are brought to his/her attention.
4. Those who are delegated tasks must have the qualifications and required proficiency to perform them tasks and should be advised in writing of their duties. The general expectation is that tasks be delegated only to individuals with the same proficiency as the delegating supervisor. In certain limited circumstances, it may be acceptable to delegate specialized tasks to an individual that has not satisfied the proficiency requirements provided that the individual has equivalent training, education or experience related to the function being performed. The Member must consider the responsibilities and functions to be performed in relation to the delegated tasks and make a determination as to appropriate equivalent qualifications and proficiency. The Member must be able to demonstrate to MFDA staff that the equivalency standard has been met. Tasks related to trade supervision can only be delegated to individuals that possess the proficiency of a branch manager or compliance officer.

Education

1. The Member's current policies and procedures manual must be made available to all sales and supervisory personnel.
2. Introductory training and continuing education should be provided for all registered salespersons. For training and enhanced supervisory requirements for newly registered salespersons, please refer to the MFDA Policy No.1 entitled "New Registrant Training and Supervision Policy."
3. Relevant information contained in compliance-related bulletins from the MFDA Member Regulation Notices and Bulletins and compliance-related notices from other applicable regulatory bodies must be communicated to all registered salespersons and relevant employees. Procedures relating to the method and timing of distribution of compliance-related bulletins information must be clearly detailed in the Member's written procedures. Members should ensure that they maintain evidence of compliance with such procedures.

II. OPENING NEW ACCOUNTS

To comply with the "Know-Your-Client" and suitability requirements set out in ~~Section 2 of the MFDA Rules 2~~, each Member must establish procedures to maintain accurate and complete information on each client. The first step towards compliance with this rule is completing proper documentation when opening new accounts. Accurate completion of the documentation when opening a new account allows both the registered salesperson and the supervisory staff to conduct the necessary reviews to ensure that recommendations made for any account are appropriate for the client and in keeping with investment objectives. Maintaining accurate and current documentation will allow the registered salesperson and the supervisory staff to ensure that all recommendations made for any account are and continue to be appropriate for a client's investment objectives.

Documentation of Client Account Information

1. ~~A New Account Application Form ("NAAF") must be completed for each new account. A sample NAAF is attached as Schedule "I". If the NAAF does not include know your client ("KYC") information, this must be documented on a separate KYC form. Such form or forms shall be duly completed to conform with the KYC rule.~~

SRO Notices and Disciplinary Proceedings

- ~~2. The new account or KYC information must be approved in writing by the branch manager or the designated director, partner or officer, prior to the initial trade or promptly thereafter (in any event, by no later than one business day after the date of the initial trade).~~
- ~~3. A complete set of documentation must be maintained by the Member. The registered salesperson must also maintain a copy of the NAAF. In the case of a Level 1 Introducing Dealer and corresponding Carrying Dealer, both Members must maintain a copy of each client's NAAF.~~
- ~~4. The registered salesperson or Member must update the form documenting KYC information whenever they become aware of a material change in client information. Notwithstanding the foregoing, Members must, on an annual basis, request in writing that clients notify them if the KYC information previously provided, or the client's circumstances, have materially changed.~~
- ~~5. The last date upon which the form documenting KYC information has been updated must be indicated in the client's file.~~
- ~~6. When there is a change of registered salesperson, the new registered salesperson must verify the information on the NAAF and any separate KYC form to ensure it is current and record the date of such verification on the form or forms.~~
- ~~7. Account numbers must not be assigned unless they are accompanied by the proper name and address of the client and such name and address must be supported by a properly completed NAAF no later than the following day.~~
- ~~8. New NAAF's should be prepared and completed for all new clients, including existing clients of a registered salesperson transferring to the Member.~~
1. A New Account Application Form ("NAAF") must be completed for each new account.
2. A complete set of documentation relating to each client's account must be maintained by the Member. The registered salesperson must also maintain a copy of the NAAF. In the case of a Level 1 Introducing Dealer and corresponding Carrying Dealer, both Members must maintain a copy of each client's NAAF.
3. For each account of a client that is a natural person, the Member must obtain information sufficient to allow for the operation of the account and sufficient to determine the essential facts relative to each client (the "know-your-client" or "KYC" information), which would include, at a minimum, the following information:
 - (a) name;
 - (b) type of account;
 - (c) residential address and contact information;
 - (d) date of birth;
 - (e) employment information;
 - (f) number of dependants;
 - (g) other persons with trading authorization on the account;
 - (h) other persons with a financial interest in the account;
 - (i) investment knowledge;
 - (j) risk tolerance;
 - (k) investment objectives;
 - (l) time horizon;
 - (m) income;
 - (n) calculation of net worth (including details of liquid assets, fixed assets and liabilities);
 - (o) information required for relevant tax reporting;

(p) information required for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations*, as amended from time to time;

(q) authorization to provide personal information to the MFDA under applicable privacy legislation.

The preceding provides a list of minimum requirements. The Member may require clients to provide any additional information that it considers relevant. In the case of accounts jointly owned by two or more persons, the minimum information noted above should be collected with respect to each owner, with the exception of the information required under subparagraphs (b), (h), (i), (k), (l) and (m).

3. For each account of a client that is a corporation, trust or other type of legal entity, the Member must obtain information sufficient to allow for the operation of the account and sufficient to determine the essential facts relative to the client, which would include, at a minimum, the following information:

(a) legal name;

(b) head office address and contact information;

(c) type of legal entity (i.e. corporation, trust, etc.);

(d) form and details regarding the organization of the legal entity (i.e. articles of incorporation, trust deed, or other constating documents)

(e) nature of business;

(f) persons authorized to provide instructions on the account and details of any restrictions on their authority;

(g) investment knowledge of the persons to provide instructions on the account;

(h) risk tolerance;

(i) investment objectives;

(j) time horizon;

(k) income;

(l) calculation of net worth (including details of liquid assets, fixed assets and liabilities);

(m) information required for relevant tax reporting;

(n) information required for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations*, as amended from time to time;

(o) authorization to provide personal information to the MFDA under applicable privacy legislation.

The preceding provides a list of minimum requirements. The Member may require clients to provide any additional information that it considers relevant.

5. For supervisory purposes, registered accounts, leveraged accounts and accounts of any registered salesperson's family member operating under a limited trading authorization or operating under a power of attorney in favour of the registered salesperson must be readily identifiable.

6. If the NAAF does not include KYC information, this must be documented on a separate KYC form(s). Such form(s) must be signed by the client and dated. A copy of the completed NAAF and KYC form, if separate from the NAAF, must be provided to the client.

7. The Member must have internal controls and policies and procedures in place with respect to the entry of KYC information on their back office systems. Such controls should provide an effective means to detect and prevent inconsistencies between the KYC information used for account supervision with that provided by the client.

8. Except as noted in the following paragraph, NAAF's must be prepared and completed for all new clients prior to the opening of new client accounts. The new account or KYC information must be approved by the individual designated as

responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the date that the account is opened. Records of all such approvals must be maintained in accordance with Rule 5.

9. Notwithstanding the preceding paragraph, NAAF's for clients of a registered salesperson transferring to the Member must be prepared and completed within a reasonable time (but in any event no later than the time of the first trade). The new accounts or KYC information for clients of the transferring salesperson must be approved by the individual designated as responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the date that the NAAF is completed. Records of all such approvals must be maintained in accordance with Rule 5.
10. In the event that a NAAF is not completed prior to or within a reasonable time after opening an account, as required by this Policy, the Member must have policies and procedures to restrict transactions on such accounts to liquidating trades until a fully completed NAAF is received.
11. When there is a change of registered salesperson responsible for a client's account at a Member, the new registered salesperson must review the information on the NAAF and any separate KYC form to ensure it is current and record the date of such review on the form or forms.

Changes to Know-Your-Client Information

1. The registered salesperson or Member must update the KYC information whenever they become aware of a material change in client information as defined in Rule 2.2.4.
2. On account opening, the Member should advise the client to promptly notify the Member of any material changes in the client information previously provided to the Member and provide examples of the types of information that should be regularly updated.
3. In accordance with Rule 2.2.4(e), Members must also, on an annual basis, request in writing that clients notify them if there has been any material change in client information previously provided, or if the client's circumstances have materially changed.
4. Access to amend KYC information must be controlled and instructions to make any such amendments must be properly documented.
5. A client signature, which may include an electronic signature, must be obtained to evidence any change in client name, client address or client banking information.
6. Other material changes to client information may be evidenced by a client signature, which may include an electronic signature or, alternatively, such changes may be evidenced by maintaining notes in the client file detailing the client's instructions to change the information and verified by providing written confirmation to the client with details of the instructions and providing an opportunity for the client to make corrections to any changes that have been made.
7. All material changes in client information must be approved by the individual designated as responsible for the opening of new accounts under Rule 2.2.3 no later than one business day after the date on which notice of the change in information is received from the client. Records of all such approvals must be maintained in accordance with Rule 5.
8. Where any material changes have been made to the information contained in the NAAF or KYC form(s), the client must promptly be provided with a document or documents specifying all KYC information that applies to the client's account.
9. The last date upon which the KYC information has been updated or confirmed must be indicated in the client's file and on the Member's back office system.

Pending/Supporting Documents

1. Members must have procedures in place to ensure supporting documents are received within a reasonable period of time of opening the account.
2. Supporting documentation that is not received or is incomplete must be noted, filed in a pending documentation file and reviewed on a periodic basis.
3. Failure to obtain required documentation within 25 days of the opening of the account must result in positive actions being taken.

Client Communications Master Files

- ~~1. Entering and amending client master files must be controlled and accompanied by proper documentation.~~
- ~~2.1. All hold mail must be authorized by the client in writing and be controlled, reviewed on a regular basis and maintained by the responsible supervisor. Hold mail should never be permitted to occur over a prolonged period of time (i.e. in excess of 6 months).~~
- ~~3.2. Returned mail is to be promptly investigated and controlled.~~
- ~~4. For supervisory purposes, registered accounts, leveraged accounts and accounts operating under a limited trading authorization must be readily identifiable.~~

III. ASSESSING SUITABILITY OF INVESTMENTS AND LEVERAGING STRATEGIES

- ~~1. In accordance with Rule 2.2.1, Members and registered salespersons are responsible for the suitability of each recommendation made for an account of a client and must assess the suitability of the investments in each client's account under the circumstances described in Rule 2.2.1(e).~~
- ~~2. Members must have policies and procedures with respect to their suitability obligations, including criteria for the purpose of assessing the suitability of a client's use of leveraging and describing appropriate client circumstances for recommending the use of leverage.~~
- ~~3. The Member's policies and procedures must describe the information required to be maintained in the client file to facilitate proper Member supervision. Whenever the Member or registered salesperson recommends or becomes aware that a client is using a leverage strategy, the Member or registered salesperson must either maintain copies of the lending documents or make sufficient inquiries to obtain details of the loan, including interest rate, terms for repayment and the outstanding loan value. Where the Member or registered salesperson assists the client in completing the loan application, the Member must maintain copies of lending documents in the file, including copies of the loan application.~~
- ~~4. The Member's criteria for selecting trades for review, the inquiry and resolution process, supervisory documentation requirements, and the escalation and disciplinary process must be documented and clearly communicated to all registered salespersons and all relevant employees. Registered salespersons must be advised of the criteria the Member uses in assessing suitability, actions the Member will take when a trade has been flagged for review and appropriate options for resolution.~~
- ~~5. Registered salespersons must assess the suitability of investments in each client account within a reasonable time, but in any event no later than the time of the next trade, whenever:
 - ~~– the client transfers to the Member or transfers assets into an account at the Member;~~
 - ~~– the Member or registered salesperson becomes aware of a material change in the client's KYC information; and~~
 - ~~– the client account has been re-assigned to the registered salesperson from another registrant at the Member.~~~~

~~The determination of "reasonable time" in a particular instance will depend on the circumstances surrounding the event that gives rise to the requirement to perform the suitability assessment. For example, with respect to client transfers, the volume of accounts to be reviewed may be a relevant factor in determining reasonable time.~~

- ~~6. Should a registered salesperson identify unsuitable investments in a client's account, the registered salesperson must advise the client and take appropriate steps to determine if there has been any change to client circumstances that would warrant altering the KYC information. It is inappropriate to alter the KYC information in order to match the investments in the client's account. If there is no change to the KYC information, or if investments in the account continue to be unsuitable after the KYC information has been amended, the registered salesperson should discuss any inconsistencies with the client and provide recommendations as to rebalancing investments in the account. Transactions in the account must only be made in accordance with client instructions and any recommendations made with respect to the rebalancing of the account must be properly recorded.~~
- ~~7. Registered salespersons must maintain evidence of completion of all suitability assessments performed and any follow up action taken with respect to such assessments.~~

III. BRANCH OFFICE ACCOUNT SUPERVISION

Each branch manager must undertake certain activities within the branch for purposes of assessing compliance with the Member's policies and procedures and regulatory requirements. These activities should be designed to identify failures to adhere to required policies and procedures and provide a means of revealing and addressing undesirable account activity.

Daily Activity

1. All new account applications and updates to client information must be reviewed and approved in accordance with this Policy, no later than the next business day after the account is opened.
2. The branch manager (or alternate) must review the previous day's trading for unsuitable trades and any other unusual trading activity using any convenient means. This review must ~~should~~ include, at a minimum, all: ~~trades in exempt securities (excluding guaranteed investment certificates) where permitted by securities law, and a sample of:~~
 - initial trades;
 - trades in exempt securities;
 - leveraged trades/leverage recommendations for open accounts;
 - trades over \$1,000 in moderate-high or high risk investments; in volatile or speculative funds; and
 - trades in accounts of family members of registered salespersons operating under a power of attorney in favour of the registered salesperson; and limited trading authorizations.
 - trades and redemptions over \$5,000 for all other investments.

For the purposes of this section, "trades" does not include redemptions except where specifically referenced.

3. When reviewing redemptions, branch managers should seek to identify and assess:
 - the suitability of the redemption with regard to the composition of the remaining portfolio;
 - the impact and appropriateness of any redemption charges;
 - possible outside business activity where money may be leaving the Member for reinvestment into other potentially inappropriate or unauthorized investments; and
 - potential churning, including situations where redemption proceeds are being held on a temporary basis pending reinvestment.
4. The branch manager (or alternate) is responsible for following up on unusual trades identified by head office.
5. The branch manager must assess the suitability of investments in each client account where the Member becomes aware of a material change in the client's KYC information. The suitability assessment must be performed no later than one business day after the date on which notice of the change in information is received from the client.
- 3-6. In addition to transactional activity, branch managers must also keep themselves informed as to other client-related compliance matters such as complaints.

IV. HEAD OFFICE ACCOUNT SUPERVISION

A two-tier structure is required to adequately supervise client account activity. While the head office or regional area level of supervision by its nature cannot be in the same depth as branch level supervision, it should cover the same elements. Head office review should be focused on unusual activity or reviews that cannot be carried out at the branch level. Head office reviews must include procedures to effectively detect unsuitable investments and excessive trading in client accounts.

Daily Reviews

1. In addition to the trading review criteria for branch managers, head office must conduct daily reviews of account activity which ~~must~~ should include, at a minimum, all: ~~criteria to detect the following:~~
 - ~~— lack of suitability;~~
 - ~~— excessive trading or switching between funds indicating possible unauthorized trading or lack of suitability;~~
 - ~~— excessive switches between no load funds and deferred sales charge or front load funds;~~
 - ~~— excessive switches between deferred sales charge funds and front load funds;~~
 - ~~— excessive forced settlements;~~
 - ~~— quality downgrading of client holdings;~~
 - ~~a. account number changes where the Member uses nominee name accounts.~~
 - ~~— trades over \$5,000 in exempt securities, moderate-high or high risk investments, or leveraged trades/recommendations in open accounts;~~
 - ~~— trades over \$10,000 for other investments (excluding money market funds); and~~
 - ~~— redemptions greater than \$10,000.~~

For the purposes of this section, “trades” does not include redemptions except where specifically referenced.

2. There must be closer supervision of trading by registered salespersons who have had a history of questionable conduct. Questionable conduct may include trading activity that frequently raises questions in account reviews, frequent or serious complaints, regulatory investigations or failure to take remedial action on account problems identified.
3. Daily reviews should be completed within one business day unless precluded by unusual circumstances.
4. Daily reviews should be conducted of client accounts of producing branch managers.
5. On a sample basis, the Member must review the suitability of investments in accounts where clients have transferred assets into an account or where there has been a material change in client information. The Member must have policies and procedures regarding sample size and selection, which should be based on the risk level associated with the account, focusing on accounts that hold higher risk investments, exempt securities or products not normally sold by the Member, accounts that are operated under a power of attorney in favour of a registered salesperson and accounts employing a leverage strategy. The Member’s reviews must be completed within a reasonable time.

Client Statement Reviews

1. ~~A sample of client account statements must be reviewed as frequently as they are required to be produced according to MFDA Rule 5.3.1 and such review should encompass areas of concern as discussed in the daily activity review.~~
2. ~~Reviews should be completed within 21 days of the period covered by the statement unless precluded by unusual circumstances.~~
3. ~~Evidence of all reviews should be kept including date of completion, actions and responses and must be maintained for at least two years.~~

VI. IDENTIFICATION OF TRENDS IN TRADING ACTIVITY

1. In addition to performing daily reviews, Members must establish policies and procedures to identify trends or patterns that may be of concern including:
 - ~~— excessive trading or switching between funds indicating possible unauthorized trading, lack of suitability or possible issues of churning (for example, redemptions made within 3 months of a purchase, DSC purchases made within 3 months of a DSC redemption or accounts where there are more than 5 trades per month);~~

SRO Notices and Disciplinary Proceedings

- excessive switches between no load funds and deferred sales charge or front load funds;
- excessive switches between deferred sales charge funds and front load funds; and
- excessive switches where a switch fee is charged.

2. Head office supervisory review procedures must include, at a minimum, the following criteria:

- a review of all accounts generating commissions greater than \$1,500 within the month;
- a quarterly review of reports on assets under administration ("AUA") comparing current AUA to AUA at the same time the prior year;
- a quarterly review of commission reports for the previous 12 month period comparing commissions received in the current year to commissions received for the same period in the prior year.

Significant increases in commissions or AUA beyond those caused by market fluctuations may indicate issues with churning or leveraging strategies. Significant decreases may indicate potential inappropriate outside business activity.

3. Reviews should be completed within 21 days of the last day of the period being reviewed unless precluded by unusual circumstances.

SCHEDULE I TO POLICY NO. 2
SAMPLE NEW ACCOUNT APPLICATION FORM
 (To be completed by Approved Person)

1. a) Name: Mr. _____ Contact: Home _____

 Mrs. _____ Business: _____
 Ms. _____ (Please Print) _____ Other: _____
 _____ Fax: _____
 Address: _____ Email: _____
 Apt/Number _____ Street _____ Date of Birth: _____ / _____ / _____
 dd / mm / yy
 Address: _____ SIN Number: _____
 City Province _____ Postal Code _____

b) IF APPLICABLE
 Name: Mr. _____ Contact: Home: _____

 Mrs. _____ Business: _____
 Ms. _____ (Please Print) _____ Other: _____
 _____ Fax: _____
 Address: _____ Email: _____
 Apt/Number _____ Street _____ Date of Birth: _____ / _____ / _____
 dd / mm / yy
 Address: _____ SIN Number: _____
 City Province _____ Postal Code _____

2. CLIENT'S EMPLOYER
 Name: _____ Type of Business: _____
 Address: _____ Client's Occupation: _____

3. FAMILY INFORMATION
 Spouse's Name: _____ Number of Dependants: _____
 Spouse's Occupation: _____

4. Will any other person or persons:
 a) Have trading authorization in this account? Yes ___ No ___ (If Yes provide particulars)

 (Trading Authorization held by a third party
 for the client's account must be documented)
 b) Have a financial interest in this account? Yes ___ No ___ (If Yes provide Particulars)

5. INVESTMENT KNOWLEDGE RISK TOLERANCE		INDIVIDUAL INCOME	
Extensive _____	Low _____	Under \$20,000 _____	
Moderate _____	Medium _____	\$20-50,000 _____	
None _____	High _____	\$50-100,000 _____	
		Over \$100,000 _____	
INVESTMENT OBJECTIVES- TIME HORIZON		HOUSEHOLD NET WORTH	
Income _____	1-3 yrs. _____	Under \$25,000 _____	
Growth _____	4-5 yrs. _____	\$25-50,000 _____	
-short term _____	6-9 yrs. _____	\$50-100,000 _____	
-long term _____	10 yrs. or more _____	\$100-250,000 _____	
Balanced _____		Over \$250,000 _____	

6. LEVERAGING
 The client has been provided with a leveraging disclosure document in compliance with MFDA Rules. Yes ___

7. BANKING INFORMATION
 Bank Name: _____ Account Number: _____
 Branch Address: _____ Transit Number: _____

8. Client Signature: _____ Date: _____
 Salesperson Signature: _____ Date: _____
 Designated Officer, Director, or _____ Date of
 Branch Manager Approval: _____ Approval: _____

9. CLIENT IDENTIFICATION:
 1. _____ 2. _____

10. UPDATES TO CLIENT INFORMATION:

