

MFDA BY-LAW, RULES AND POLICIES

**Administrative version
October 1, 2010**

INTRODUCTION

This document constitutes an administrative version of the By-Law, Rules and Policies of the Mutual Fund Dealers Association of Canada (« MFDA ») prepared by the Autorité des marchés financiers («AMF»).

The rule language used being the one of an association; the meaning of the specific terms identified below must be the following through the adoption of the MFDA regulations in Quebec:

- « the Association » means the Autorité des marchés financiers
- « member » means a mutual fund dealer registered with the Autorité des marchés financiers
- « authorized person » means a mutual fund representative registered with the Autorité des marchés financiers

By-Law No. 1

As only a number of definitions included in section 1 of By-Law No. 1 will have force of law in Quebec, the administrative version solely includes the relevant definitions instead of reproducing the entire By-Law.

Rules and Policies

The administrative version duplicates the MFDA Rules and Policies in their entire forms.

The rules or part of rules deemed not consistent with the Quebec laws and regulations are strikethrough. The parts identified as such are excluded from the new regulation pertaining to mutual fund sector.

A number of rules and one policy are currently subject to an amendment process from the MFDA. Should amendments be adopted by the MFDA before September 28th 2011 when the new regulation becomes effective, the AMF will then inform the mutual fund industry.

Extracts of MFDA By-Law No. 1

INTERPRETATION AND EFFECT

1. DEFINITIONS

In this By-law and in the Rules and Policies, unless the context otherwise specifies or requires:

"**affiliate**" or "**affiliated corporation**" means in respect of two corporations, either corporation if one of them is the subsidiary of the other or if both are subsidiaries of the same corporation or if each of them is controlled by the same person;

"**associate**", where used to indicate a relationship with any person, means:

- (a) any corporation of which such person beneficially owns, directly or indirectly, voting securities carrying more than 10 per cent of the voting rights attached to all voting securities of the corporation for the time being outstanding;
- (b) a partner of that person acting on behalf of the partnership of which they are partners;
- (c) any trust or estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar capacity;
- (d) any relative of such person, including his/her spouse, or his/her spouse who has the same home as such person;

but where the Board of Directors orders that two persons shall, or shall not, be deemed to be associates, then such order shall be determinative of their relationships in the application of By-laws, Rules and Forms, with respect to that Member;

"**branch office**" means any office or location from which any dealer business of a Member is conducted;

"**carrying dealer**" means a Member that carries customer accounts in accordance with Rule 1.1.6 to the extent, at a minimum, of clearing and settling trades, maintaining books and records of customer transactions and the holding of client cash, securities and other property;

"**client name**" means in respect of an account or client property, an account established by a Member for a client in accordance with the By-laws and Rules, and the cash, securities or other property held for such account, where the cash, securities and property is held in the name of and by a person other than the Member, its agent or custodian;

"**control**" or "**controlled**", in respect of a corporation by another person or by two or more corporations, means the circumstances where:

- (a) voting securities of the first-mentioned corporation carrying more than 50% of the votes for the election of directors are held, other than by way of security only, by or for the benefit of the other person or by or for the benefit of the other corporations; and

- (b) the votes carried by such securities are entitled, if exercised, to elect a majority of the Board of Directors of the first-mentioned corporation,

but where the Board of Directors orders that a person shall, or shall not, be deemed to be controlled by another person, then such order shall be determinative of their relationships in the application of the By-laws, Rules, Policies and Forms with respect to that Member;

"guaranteeing" includes becoming liable for, providing security for or entering into an agreement (contingent or otherwise) having the effect or result of so becoming liable for or providing security for a person, including an agreement to purchase an investment, property or services, to supply funds, property or services or to make an investment primarily for the purpose of directly or indirectly enabling such person to perform its obligations in respect of such security or investment or assuring the investor of such performance;

"individual" means a natural person;

"introducing dealer" means a Member that introduces customer accounts to a carrying dealer in accordance with Rule 1.1.6;

"mutual fund dealer" means a person registered or licensed by a securities commission to deal in mutual fund or investment fund securities, other than a securities dealer;

"nominee name" means, in respect of an account or client property, other than client cash held in a trust account of a Member, an account established by a Member for a client in accordance with the By-laws and Rules in which the securities or other property is held by the Member, its agent or its custodian in the name of the Member or its agent or its custodian, for the benefit of the client;

"ownership interest" means all direct or indirect ownership of the securities of a Member;

"person" means an individual, a partnership, or corporation, a government or any department or agency thereof, a trustee, any unincorporated organization and the heirs, executors, administrators or other legal representatives of an individual;

"related Member" means a partnership or corporation which:

- (a) is a Member; and
- (b) is related to a Member in that either of them, or their respective partners, directors, officers, shareholders and employees, individually or collectively, have at least a 20% ownership interest in the other of them, including an interest as a partner or shareholder, directly or indirectly, and whether or not through holding companies;

provided that the Board of Directors may, from time to time, include in, or exclude from this definition any person, and change those included or excluded;

"securities dealer" means a person acting as dealer (principal) or broker (agent) in carrying out transactions in securities and commodity futures contracts or options on behalf of clients and includes, without limitation, acting as an underwriter or advisor, but excludes a person registered or licensed as a mutual fund dealer;

"securities related business" means any business or activity (whether or not carried on for gain) engaged in, directly or indirectly, which constitutes trading or advising in securities for

the purposes of applicable securities legislation in any jurisdiction in Canada, including for greater certainty, securities sold pursuant to exemptions under applicable securities legislation;

"**sub-branch**" means any branch office having in total less than four Approved Persons and supervised by an Approved Person as required under the Rules who is not normally present at such sub-branch office;

"**subsidiary**", in respect of a corporation and another corporation, means the first mentioned corporation if:

- (a) it is controlled by:
 - (i) that other; or
 - (ii) that other and one or more corporations each of which is controlled by that other; or
 - (iii) two or more corporations each of which is controlled by that other; or
- (b) it is a subsidiary of a corporation that is that other's subsidiary;

MFDA Rules

1. RULE NO. 1 - BUSINESS STRUCTURES AND QUALIFICATIONS

1.1 BUSINESS STRUCTURES

1.1.1 **Members.** No Member or Approved Person (as defined in By-law 1.1) in respect of a Member shall, directly or indirectly, engage in any securities related business (as defined in By-law 1.1) except in accordance with the following:

- (a) all such securities related business is carried on for the account of the Member, through the facilities of the Member (except as expressly provided in the Rules) and in accordance with the By-laws and Rules, other than:
 - (i) such business as relates solely to trading in deposit instruments conducted by any Approved Person not on account of the Member; and
 - (ii) such business conducted by an Approved Person as an employee of a bank and in accordance with the *Bank Act (Canada)* and the regulations thereunder and applicable securities legislation.
- (b) all revenues, fees or consideration in any form relating to any business engaged in by the Member is paid or credited directly to the Member and is recorded on the books of the Member;
- (c) the relationship between the Member and any person conducting securities related business on account of the Member is that of:
 - (i) an employer and employee, in compliance with Rule 1.1.4,
 - (ii) a principal and agent, in compliance with Rule 1.1.5, or
 - (iii) an introducing dealer and carrying dealer, in compliance with Rule 1.1.6;
- (d) the business or trade or style name under which such securities related business is conducted is in accordance with Rule 1.1.7.

1.1.2 **Compliance by Approved Persons.** Each Approved Person who conducts or participates in any securities related business in respect of a Member in accordance with Rule 1.1.1.(c)(i) or (ii) shall comply with the By-laws and Rules as they relate to the Member or such Approved Person.

1.1.3 **Service Arrangements.** A Member or Approved Person may engage the services of any person including another Member or Approved Person, to provide services to the Member or Approved Person, as the case may be, provided that:

- (a) the services do not in themselves constitute securities related business or duties or responsibilities that are required to be performed by the Member or Approved Person engaging the services pursuant to the By-laws, Rules or applicable securities legislation;

- (b) any remuneration or compensation in any form in respect of such services shall only be paid or credited by the Member or Approved Person engaging the services, as the case may be, directly to the person providing the services and the payment or credit of such remuneration or compensation shall be recorded in the books and records required to be maintained in accordance with the By-laws and Rules by the Member or Approved Person engaging such services;
 - (c) the Member or Approved Person engaging the services shall remain responsible for compliance with the By-laws and Rules and any applicable legislation;
 - (d) any person preparing and maintaining books and records as a service in respect of the business of the Member or Approved Person shall do so in accordance with the requirements of Rule 5, and such books and records shall be available for review by the Member or Approved Person during normal business hours and by the Corporation in accordance with the By-laws and Rules; and
 - (e) all material terms of the services to be engaged that relate to requirements of the Member or Approved Person under the By-laws, Rules, Policies or Forms shall be evidenced in writing and a copy of such terms, together with any amendments thereto from time to time or termination, shall be provided by the Member or Approved Person promptly to the Corporation upon request, together with any other information relating thereto as may be requested by the Corporation.
- 1.1.4 **Employees.** A Member may conduct its business by Approved Persons employed as employees by it provided that:
- (a) any such employee is registered or licensed, in the manner necessary, and is in good standing, under the applicable legislation in the province or territory where the employee proposes to act;
 - (b) the Member shall be responsible for, and shall supervise, the conduct of the employee as an Approved Person in respect of the business including compliance with applicable legislation and the By-laws and Rules;
 - ~~(c) the Member shall be liable to third parties (including clients) for the acts and omissions of the employee relating to the Member's business;~~¹
 - (d) the employee is in compliance with the legislation, By-laws and Rules applicable to the employee as an Approved Person; and
 - (e) where the Member and the Approved Person employed as an employee have entered into a written agreement, it shall not contain provisions which are inconsistent with an employment relationship or with the requirements set out in paragraphs (a) to (d) inclusive, of Rule 1.1.4.
- 1.1.5 **Agents.** A Member may conduct its business by Approved Persons retained or contracted by it as agents provided that:
- (a) any such agent is registered or licensed in the manner necessary, and is in good standing, under the applicable legislation in the province or territory where the agent proposes to act;

¹ Rule not consistent with the system of civil law liability.

- (b) the Member shall be responsible for, and shall supervise, the conduct of the agent in respect of the business including compliance with applicable legislation and the By-laws and Rules;
- ~~(c) the Member shall be liable to third parties (including clients) for the acts and omissions of the agent relating to the Member's business;~~²
- (d) the agent is in compliance with the legislation, By-laws and Rules applicable to the agent;
- ~~(e) the financial institution bonds and insurance policies required to be maintained by the Member pursuant to Rule 4 cover and relate to the conduct of the agent;~~³
- (f) all books and records prepared and maintained by the agent in respect of such business of the Member shall be in accordance with Rule 5 and applicable legislation, shall be the property of the Member and shall be available for review by and delivery to the Member during normal business hours;
- (g) all such business conducted by the agent is in the name of the Member subject to the provisions of Rule 1.1.7;
- (h) the agent shall not conduct securities related business with or in respect of any person other than the Member;
- (i) if the agent is engaged in or carrying on any business or activity other than business conducted on behalf of the Member, including any business or activity which is subject to regulation by any regulatory authority other than a securities commission, compliance with the terms of the agreement referred to in paragraph (k) shall be monitored and enforced directly by the Member and not by or through any other person including another employer or principal of the agent;
- (j) the terms or basis on which the agent may be engaged in or carry on any business or activity other than business conducted on behalf of the Member shall not prevent or impair the ability of the Member or the Corporation from monitoring and enforcing compliance by the agent with the terms of the agreement referred to in paragraph (k) or the By-laws or Rules; and
- (k) the Member and the agent shall have entered into an agreement in writing, which shall be provided promptly to the Corporation upon request, containing terms which include the provisions of paragraphs (a) to (j), inclusive, and which do not include provisions which are inconsistent with paragraphs (a) to (j), and shall provide the Corporation with a certificate signed by an officer or director of such Member and, upon request by the Corporation, shall provide an opinion of counsel, confirming the agreement is in compliance with such provisions.

1.1.6 Introducing and Carrying Arrangement

- (a) **Permitted Arrangements.** A Member may enter into an arrangement with another Member pursuant to which the accounts of one Member (the "introducing dealer") are carried by the other Member (the "carrying dealer") provided that:

² Rule not consistent with the system of civil law liability.

³ Rule not consistent with the mutual fund dealer liability insurance regime referred to in section 193 of the Securities Regulation.

- (i) the arrangement shall satisfy the requirements of a carrying arrangement described in Rule 1.1.6(b);
- (ii) an introducing dealer shall not introduce accounts to any person who is not a Member;
- (iii) an introducing dealer may not introduce accounts to more than one Member, except that a Level 2, 3 or 4 Member may introduce to another Member accounts of clients which are self-directed plans registered for income tax purposes;
- (iv) the Members shall enter into a written agreement evidencing the arrangement and reflecting the requirements of Rule 1.1.6(b) and such other matters as may be required by the Corporation;
- (v) the arrangement (including the form of agreement referred to in Rule 1.1.6(b)) and any amendment to or termination of the arrangement or agreement, shall have been approved by the Corporation before it is to become effective; and
- (vi) the arrangement shall be in compliance with the By-laws and Rules and the securities legislation applicable to either of the Members.

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

- (i) Minimum Capital. The carrying dealer shall maintain at all times minimum capital of a Level 4 Dealer, and the introducing dealer shall maintain at all times minimum capital of a Level 1, 2, 3 or 4 Dealer, as the case may be;
- (ii) Reporting of Client Balances. In calculating the risk adjusted capital required pursuant to Rule 3.1.1 and Form 1, the carrying dealer shall report all accounts of the clients (introduced by the introducing dealer to the carrying dealer and for whom assets are held in nominee name) on the carrying dealer's Form 1 and Monthly Financial Report;
- (iii) Comfort Deposit. Any deposit (other than deposits on behalf of clients) provided to the carrying dealer by the introducing dealer pursuant to the terms of the agreement between them shall be segregated in accordance with Rule 3.3 by the carrying dealer and shall be held by the carrying dealer in a separate designated trust account for the introducing dealer;

The deposit provided by the introducing dealer to the carrying dealer shall be reported by the introducing dealer as an allowable asset on its Form 1 and Monthly Financial Report;

- (iv) Segregation of Client Cash and Securities. The carrying dealer shall be responsible for holding and segregating in accordance with the requirements of Rule 3.3 all cash and securities held for clients introduced to it by an introducing dealer, provided that a Level 3 introducing dealer may hold cash, and a Level 4 introducing dealer may hold cash and securities, for the accounts of clients to the extent to which such functions are not part of the services to be provided by the carrying dealer;

- (v) Trust Accounts. The carrying dealer shall be responsible for and shall maintain in its name any trust accounts established in respect of cash received for the account of clients introduced to it by the introducing dealer, provided that a Level 3 or 4 introducing dealer may hold cash in such trust accounts to the extent to which such functions are not part of the services to be provided by the carrying dealer;
- ~~(vi) Insurance. The introducing dealer and carrying dealer shall each maintain minimum insurance in the amounts required and in accordance with Rule 4;~~
- ~~(vii) Amount of Insurance. The carrying dealer shall include all accounts introduced to it by the introducing dealer that are held in nominee name in its calculation of the "base amount" asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E) under Rule 4;~~⁴
- (viii) Disclosure and Acknowledgement on Account Opening. At the time of opening each client account, the introducing dealer shall advise the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer and, in the case of a Level 1 or 2 introducing dealer, obtain from the client an acknowledgement in writing to the effect that such advice has been given. In the case of a Level 2 introducing dealer, the acknowledgement shall reflect that the introducing dealer has advised the client that the carrying dealer shall be responsible for and shall maintain in its name any trust accounts established in respect of cash received from clients and that all client cheques shall be payable to the carrying dealer;
- (ix) Contracts, Account Statements, Confirmations and Client Communications. The name and role of each of the carrying dealer and the introducing dealer shall be shown on all contracts, account statements, confirmations and, in the case of a Level 1 introducing dealer, all client communications (as defined in Rule 2.8.1) and advertisements and sales communications (as defined in Rule 2.7.1) sent by either the introducing dealer or the carrying dealer in respect of accounts carried by the carrying dealer. In the case of a Level 1 introducing dealer, the name and role of the carrying dealer shall appear in at least equal size to that of the introducing dealer. The use of business or trade or style names shall be in accordance with Rule 1.1.7 as applicable. The carrying dealer shall be responsible for sending account statements and confirmations to clients introduced to it by the introducing dealer as required by the By-laws and Rules to the extent such statements and confirmations relate to trading or account positions in respect of which the carrying dealer has provided services;
- (x) Annual Disclosure. A Level 3 or Level 4 introducing dealer may comply with the disclosure requirements under paragraph (ix) by providing written disclosure at least annually to each of its clients whose accounts are being carried by the carrying dealer, outlining the relationship between the introducing dealer and the carrying dealer and the relationship between the client and the carrying dealer;

⁴ Rule not consistent with the mutual fund dealer liability insurance regime referred to in section 193 of the Securities Regulation.

- (xi) Clients Introduced to the Carrying Dealer. Each client introduced to the carrying dealer by the introducing dealer shall be considered a client of the carrying dealer for the purposes of complying with the By-laws and Rules to the extent of the services provided by the carrying dealer; and
- (xii) Responsibility for Compliance. Unless otherwise specified in Rule 2 or in this Rule 1.1.6, the introducing dealer which is a Level 1 Dealer and its carrying dealer shall be jointly and severally responsible for compliance with the By-laws and Rules for each account introduced to the carrying dealer by the introducing dealer, and in all other cases the introducing dealer shall be responsible for such compliance, subject to the carrying dealer being also responsible for compliance with respect to those functions it agrees to perform under the arrangement entered into under this Rule 1.1.6.

1.1.7 **Business Names, Styles, Etc.**

- (a) **Use of Member Name.** Except as permitted pursuant to Rule 1.1.6 with respect to introducing dealers and carrying dealers and subject to Rule 1.1.7(b) and (c), all business carried on by a Member or by any person on its behalf shall be in the name of the Member or a business or trade or style name owned by the Member or an affiliated corporation of the Member.
- (b) **Contracts, Account Statements and Confirmations.** Notwithstanding the provisions of paragraph (a), the legal name of the Member shall be included on any contracts, account statements or confirmations of the Member.
- (c) **Use of Approved Person Trade Name.** Notwithstanding the provisions of paragraph (a), an Approved Person may conduct any business of the Member in a business or trade name or style name that is not that of, or owned by, the Member or its affiliated corporation if:
 - i) the Member has given its prior written consent; and
 - ii) in all materials communicated to clients or the public (other than contracts, account statements or confirmations in accordance with (iii)):
 - (A) the name is used together with the Member's legal name; and
 - (B) the Member's legal name or a business or trade or style name of the Member is at least equal in size and prominence to the business or trade or style name used by the Approved Person;
 - iii) on contracts, account statements or confirmations, the Member's legal name must be at least equal in size and prominence to the business or trade or style name used by the Approved Person.
- (d) **Notification of Trade Names.** Prior to the use of any business or style or trade names other than the Member's legal name, the Member shall notify the Corporation.
- (e) **Compliance with Applicable Legislation.** Any business or trade or style name used by a Member or Approved Person must comply with the requirements of any applicable legislation relating to the registration of business or trade or style names.
- (f) **Single Use of Trade Names.** No Member or Approved Person of such Member shall use any business or trade or style name that is used by any other Member, unless

the relationship with such other Member is that of an introducing dealer and carrying dealer, in compliance with Rule 1.1.6.

- (g) **Misleading Trade Name.** No Member or Approved Person shall use any business or trade or style name that is deceptive, misleading or likely to deceive or mislead the public.
- (h) **Prohibition of Use of Trade Name.** The Corporation may prohibit a Member or Approved Person from using any business or trade or style name in a manner that is contrary to any provision of this Rule 1.1.7 or that is objectionable or contrary to the public interest.

1.2 INDIVIDUAL QUALIFICATIONS

1.2.1 Salespersons

- (a) **Course Requirements.** Each Approved Person who is a salesperson and who trades or deals in securities for the purposes of any applicable legislation in respect of a Member shall have successfully completed any one of the following courses:
 - (i) the Canadian Securities Course offered by the Canadian Securities Institute;
 - (ii) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada;
 - (iii) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers;
 - (iv) the Principles of Mutual Funds Course formerly offered by the Trust Companies Institute; or
 - (v) to the extent the Approved Person trades or deals in securities in the Province of Quebec only, the courses entitled Placements des particuliers (CEGEP) and Cours sur les fonds distincts et fonds communs de placement offered by the Canadian Securities Institute.
- ~~(b) **Compliance with MFDA Requirements.** Each Member shall ensure that any Approved Person who conducts any business on behalf of the Member executes and delivers to the Member an agreement in a form as prescribed from time to time by the Corporation agreeing, among other things, to be subject to, comply with and be bound by the By-laws and Rules.~~⁵
- (c) **Training and Supervision.** Upon commencement of trading or dealing in securities for the purposes of any applicable legislation on behalf of a Member, all Approved Persons who are salespersons shall complete a ~~training program within 90 days of such commencement and a concurrent~~ six month supervision period in accordance with such terms and conditions as may be prescribed from time to time by the Corporation, unless he or she has completed a ~~training program and~~ supervision period in accordance with this Rule with another Member or was licensed or registered in the manner necessary, and is in good standing, under applicable

⁵ Rule deemed not consistent as the MFDA rules adopted by the Autorité des marchés financiers will have force of rule enforceable against the mutual fund dealers and their representatives.

securities legislation to trade in mutual fund securities prior to the date of this Rule becoming effective.⁶

(d) **Dual Occupations.** An Approved Person may have, and continue in, another gainful occupation, provided that:

- (i) *Permitted by legislation.* The securities commission in the jurisdiction in which the Approved Person carries on or proposes to carry on business specifically permits him or her to devote less than his or her full time to the business of the Member for which he or she acts on behalf of;
- (ii) *Not prohibited.* The securities commission in the jurisdiction in which the Approved Person carries on or proposes to carry on business does not prohibit an Approved Person from engaging in such gainful occupation;
- (iii) *Member approval.* The Member for which the Approved Person carries on business either as an employee or agent is aware and approves of the Approved Person engaging in such other gainful occupation;
- (iv) *Member procedures.* Such Member establishes and maintains procedures to ensure continuous service to clients and to address potential conflicts of interest;
- (v) *Conduct unbecoming.* Any such gainful occupation of the Approved Person must not be such as to bring the Corporation, its Members or the mutual fund industry into disrepute;
- (vi) *Disclosure.* Clear disclosure is provided to clients that any activities related to such other gainful occupation are not business of the Member and are not the responsibility of the Member; and
- ~~(vii) *Financial planning.* Any Approved Person that engages in financial planning services otherwise than through or on behalf of a Member must:~~
 - ~~(A) *Regulations* – provide such services through another person that is either regulated by a governmental authority or statutory agency or subject to the rules and regulations of a widely-recognized professional association;~~
 - ~~(B) *Legislation* – comply with the requirements of any applicable legislation in connection with the services;~~
 - ~~(C) *Access* – ensure that, subject to any applicable legislation, the Member and the Corporation have access to financial plans prepared on behalf of the clients of the Member by its Approved Persons; and~~
 - ~~(D) *Proficiency* – have satisfied any applicable proficiency requirements by securities regulatory authorities having jurisdiction.~~⁷

⁶ The part of paragraph (c) pertaining to the training program is not consistent with the *Regulation of the Chambre de la sécurité financière respecting compulsory professional development* applicable to the mutual fund representatives registered with the Autorité des marchés financiers.

⁷ Rule not consistent with the provisions of *An Act respecting the distribution of financial products and services* overseeing financial planning.

- (e) **Business Titles.** No Approved Person shall hold him or herself out to the public in any manner including, without limitation, by the use of any business name or designation of qualifications or professional experience that deceives or misleads, or could reasonably be expected to deceive or mislead, a client or any other person as to the proficiency or qualifications of the Approved Person under the Rules or any applicable legislation.

1.2.2 Branch Managers

- (a) **Proficiency Requirements.** An individual may not be designated by the Member as a branch manager pursuant to Rule 2.5.3(a) or an alternate branch manager pursuant to Rule 2.5.3(c) unless the individual has:
- (i) been licensed or registered previously under applicable securities legislation as a trading partner, director, officer or compliance officer of a mutual fund dealer; or
 - (ii) has successfully completed any one of the following courses:
 - (A) the Canadian Securities Course offered by the Canadian Securities Institute,
 - (B) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada, or
 - (C) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers,and, any one of the following courses:
 - (D) the Branch Managers' Course offered by the Canadian Securities Institute,
 - (E) the Mutual Fund Branch Managers' Course offered by the Investment Funds Institute of Canada, or
 - (F) the Branch Compliance Officers Course offered by the Institute of Canadian Bankers.
- (b) **Experience Requirements.** In addition to the requirements set out in Rule 1.2.2(a), each branch manager, except alternate branch managers, in respect of a Member shall:
- (i) have acted as a salesperson, trading partner, director, officer or compliance officer registered under the applicable securities legislation for a minimum of two years; or
 - (ii) have a minimum of two years of equivalent experience to that of an individual described in Rule 1.2.2(b)(i).

~~(c) **Registration.** Each Branch Manager, in addition to the requirements in Rule 1.2.2(a) shall be registered, licensed or approved as a branch manager under the applicable~~

~~securities legislation and comply with the requirements of such legislation in connection therewith.~~⁸

~~1.2.3 Trading Partners, Directors, Officers and Compliance Officers~~

~~(a) **Definition.** In this Rule, "trading partner, director or officer" means each partner, director or officer who is required to be registered and/or licensed under applicable securities legislation.~~

~~(b) **Course Requirements.** Each trading partner, director, officer and designated compliance officer of a Member shall have successfully completed any one of the following courses:~~

~~(i) the Canadian Securities Course offered by the Canadian Securities Institute;~~

~~(ii) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada; or~~

~~(iii) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers;~~

~~and, any one of the following:~~

~~(iv) the Partners', Directors' and Senior Officers' Qualifying Examination offered by the Canadian Securities Institute; or~~

~~(v) the Mutual Fund Officers', Partners' and Directors' Course offered by the Investment Funds Institute of Canada.~~

~~(c) **Registration.** Each trading partner, director, officer and compliance officer of a Member shall be registered and/or licensed in the appropriate category under applicable securities legislation and shall comply with the requirements of such legislation in connection therewith.~~⁹

~~1.2.4 Currency of Courses.~~

~~(a) For the purposes of Rules 1.2.1(a), 1.2.2(a) or 1.2.3(b):~~

~~(i) the courses or examinations must have been successfully completed; or~~

~~(ii) the individual must have been registered/licensed under applicable securities legislation in the equivalent category;~~

~~within three years of the relevant time for qualification or such longer period as the Corporation may determine if it is satisfied based on the individual's experience that his or her knowledge and proficiency remains relevant and current.~~

⁸ Rule not consistent as the branch manager registration category no longer exists since Regulation 31-103 came into force on September 28, 2009.

⁹ As the MFDA is not responsible for the registration of individuals, Rule 1.2.3 is deemed not consistent.

- ~~(b) Notwithstanding subsection (a), if an individual completes a course for which another course is a prerequisite, the course which is a prerequisite need not have been completed within the three year period.~~¹⁰

~~1.2.5 Reporting Requirements.~~

- ~~(a) **Member Reporting.** Every Member must report to the Corporation such information, in a manner and within such period of time, as may be prescribed by the Corporation from time to time relating to:~~
- ~~(i) complaints, criminal, civil and other legal proceedings, regulatory proceedings, arbitrations, contraventions and potential contraventions of legal and regulatory requirements, disciplinary action by regulatory bodies or by Members against Approved Persons, settlements with and compensation paid to clients, registration or licensing by any regulatory body, bankruptcies, insolvencies, garnishments and related events;~~
 - ~~(ii) investigations by the Member relating to any of the matters in sub-section (i); and~~
 - ~~(iii) information relating to the business and operation of the Member and its Approved Persons.~~
- ~~(b) **Approved Person Reporting.** Every Approved Person must report to the Member such information, in a manner and within such period of time, as may be prescribed by the Corporation from time to time relating to complaints, criminal, civil and other legal proceedings, regulatory proceedings, arbitrations, contraventions and potential contraventions of legal and regulatory requirements, disciplinary action by regulatory bodies, settlements with and compensation paid to clients, registration or licensing by any regulatory body, bankruptcies, insolvencies, garnishments and related events.~~
- ~~(c) **Failure to Report.** A Member shall be liable for and pay to the Corporation levies or assessments in the amounts prescribed from time to time by the Corporation for the failure of the Member or Approved Person to report any information required to be reported in the manner and within the period of time prescribed by the Corporation.~~

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¹⁰ Rule not consistent as the MFDA is not responsible for the registration of individuals.

¹¹ Rule not consistent with the reporting requirements of the *Securities Act*, *Securities Regulation*, Regulation 31-103 and *Regulation 33-109 respecting Registration Information* ("Regulation 33-109").

2. RULE NO. 2 - BUSINESS CONDUCT

2.1 GENERAL

2.1.1 **Standard of Conduct.** Each Member and each Approved Person of a Member shall:

- (a) deal fairly, honestly and in good faith with its clients;
- (b) observe high standards of ethics and conduct in the transaction of business;
- (c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and
- (d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation.

~~2.1.2 **Member Responsible.** Each Member shall be responsible for the acts and omissions of each of its Approved Persons and other employees and agents relating to its business for all purposes under the By-laws and Rules.~~¹²

2.1.3 Confidential Information

- (a) All information received by a Member relating to a client or the business and affairs of a client shall be maintained in confidence by the Member and its Approved Persons and other employees and agents. No such information shall be disclosed to any other person or used for the advantage of the Member or its Approved Persons or other employees or agents without the prior written consent of the client or as required or authorized by legal process or statutory authority or where such information is reasonably necessary to provide a product or service that the client has requested.
- (b) Each Member shall develop and maintain written policies and procedures relating to confidentiality and the protection of information held by it in respect of clients.

2.1.4 Conflicts of Interest

- (a) Each Member and Approved Person shall be aware of the possibility of conflicts of interest arising between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member.
- (b) In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with Rules 2.1.4(c) and (d).
- (c) Any conflict or potential conflict of interest that arises as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing to the client by the Member, or by the Approved Person as the Member directs, prior to the Member or Approved Person proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest.

¹² Rule not consistent with the system of civil law liability.

- (d) Each Member shall develop and maintain written policies and procedures to ensure compliance with Rules 2.1.4(a), (b) and (c).

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 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
- (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof.

2.2.2 **New Account Application Form**. 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 prior to or 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) 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).
- (b) 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 the 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.

2.3 POWER OF ATTORNEY/LIMITED TRADING AUTHORIZATION/DISCRETIONARY TRADING

2.3.1 (a) **Prohibition.** No Member or Approved Person shall accept or act upon a general power of attorney or other similar authorization from a client in favour of the Member or Approved Person or engage in any discretionary trading.

(b) **Exception.** Notwithstanding the provisions of paragraph (a), an Approved Person may accept or act upon a general power of attorney or similar authorization from a client in favour of the Approved Person where such client is a spouse, parent or child of the Approved Person and provided that:

- (i) the Approved Person notifies the Member of the acceptance of the general power of attorney or similar authorization;
- (ii) an Approved Person other than the Approved Person holding the general power of attorney must be the Approved Person of record on the account; and
- (iii) such other conditions as prescribed by the Corporation are met.

2.3.2 **Limited Trading Authorization.** A Member or Approved Person may accept a limited trading authorization from a client for the express purpose of facilitating trade execution. In such circumstances a form of limited trading authorization as prescribed by the Corporation must be completed and approved by the compliance officer or branch manager, and retained in the client's file.

2.3.3 **Designation.** Each trade made pursuant to a limited trading authorization and its corresponding account must be identified as such in the books and records of the Member and on any order documentation.

2.4 REMUNERATION, COMMISSIONS AND FEES

2.4.1. (a) **Payable by Member Only.** Any remuneration in respect of business conducted by an Approved Person on behalf of a Member must be paid by the Member (or its affiliates or its related Members which have received it from the Member) directly to and in the name of the Approved Person.

No Approved Person in respect of a Member shall accept or permit any associate to accept directly or indirectly, any remuneration, gratuity, benefit or any other consideration from any person other than the Member or its affiliates or its related Members, in respect of the business carried out by such Approved Person on behalf of the Member or its affiliates or its related Members.

(b) **Payment of Commissions to Unregistered Corporation.** For the purpose of this Rule, "unregistered corporation" shall be understood to mean a corporation that is, itself, not registered under securities legislation. Notwithstanding paragraph (a), where an Approved Person acts as an agent of the Member in compliance with MFDA Rule 1.1.5, any remuneration, gratuity, benefit or other consideration in respect of business conducted by the Approved Person on behalf of a Member may be paid by the Member to an unregistered corporation provided that:

- (i) such arrangements are not prohibited or otherwise limited by the relevant securities legislation or securities regulatory authorities;

- (ii) the corporation is incorporated under the laws of Canada or a province or territory of Canada;
- (iii) the Member, Approved Person and the unregistered corporation have entered into an Agreement in writing, in a form prescribed by the Corporation, in favour of the Corporation, the terms of which provide that:
 - (A) the Member and Approved Person shall comply with applicable MFDA By-laws and Rules and securities legislation and remain liable to third parties, including clients, irrespective of whether any remuneration, gratuity, benefit or any other consideration is paid to an unregistered corporation and no such payment shall, in and of itself, in any way limit or affect the duties, obligations or liability of the Member or Approved Person under MFDA Rules and applicable securities legislation;
 - (B) the Member shall engage in appropriate supervision with respect to the conduct of the Approved Person and the unregistered corporation to ensure such compliance as referred to in (A), above; and
 - (C) the Approved Person and the unregistered corporation shall provide the Member, the applicable securities commission and the MFDA with access to all books and records maintained by or on behalf of either of them for the purpose of determining compliance with MFDA Rules and applicable securities legislation.

~~(c) — Arrangements Prohibited. Paragraph (b) does not apply in respect of any such remuneration, gratuity, benefit or other consideration derived from a client in Alberta.~~¹³

2.4.2 Referral Arrangements

- (a) **Definitions.** For the purpose of this Rule 2.4.2
 - (i) a "referral arrangement" is an arrangement whereby a Member is paid or pays a fee, including fees based on commissions or sharing a commission, for the referral of a client to or from another person; and
 - (ii) a referral arrangement does not include any payment to a third party service provider where the service provider has no direct contact with clients and where the services do not constitute securities related business.
- (b) **Permitted Arrangements.** Referral arrangements may only be entered into on the following basis:
 - (i) the referral arrangement is only between a Member and another Member or between a Member and an entity that is (A) licensed or registered in another category pursuant to applicable securities legislation, (B) a Canadian financial institution for the purposes of National Instrument 14-101, (C) insurance agents or brokers, or (D) subject to such other regulatory system as may be prescribed by the Corporation;

¹³ Rule not consistent as the Autorité des marchés financiers does not have jurisdiction over activities held in Alberta.

- (ii) there is a written agreement governing the referral arrangement prior to implementation;
- (iii) all fees or other form of compensation paid as part of the referral arrangement, to or by the Member, must be recorded on the books and records of the Member; and
- (iv) written disclosure of referral arrangements must be made to clients prior to any transactions taking place. The disclosure document must include an explanation or an example of how the referral fee is calculated, the name of the parties receiving and paying the fee, and a statement that it is illegal for the party receiving the fee to trade or advise in respect of securities if it is not duly licensed or registered under applicable securities legislation to so trade or advise.

2.4.3 **Service Fees or Charges.** No Member shall impose on any client or deduct from the account of any client any service fee or service charge relating to services provided by the Member in connection with the client's account unless written notice shall have been given to the client on the opening of the account or not less than 60 days prior to the imposition or revision of the fee or charge. For the purposes of this Rule, service fees or charges shall not include any commissions charged for executing trades.

2.5 MINIMUM STANDARDS OF SUPERVISION

2.5.1 **Member Responsibilities.** Each Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of its business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation.

2.5.2 Compliance Officer

- (a) **Designation.** Each Member must designate a trading officer as a "compliance officer" who shall be or report to a member of senior management such as the Member's chief executive officer, chief operating officer or chief financial officer.
- (b) **Responsibilities.** The compliance officer shall be responsible for monitoring adherence by the Member and any person conducting business on account of the Member to the By-laws, Rules and Policies, including, without limitation, standards of business conduct under Rule 2 and applicable securities legislation requirements. The compliance officer or the individual to whom the compliance officer reports is required to report on the status of compliance at the Member to the board of directors or partners of the Member as necessary, and at least on an annual basis. It shall be the responsibility of the board of directors or partners of the Member to act on the annual report and to rectify any compliance deficiencies noted in the report.
- (c) **Alternates.** In the event that a compliance officer is temporarily absent or unable to perform his or her responsibilities, a Member shall designate one or more alternates who must be qualified as compliance officers pursuant to Rule 1.2.3 and who shall carry out the responsibilities of the compliance officer.

2.5.3 Branch Manager

- (a) **Designation.** Each Member shall designate a person qualified as a branch manager pursuant to Rule 1.2.2 for each branch office (as defined in By-law 1.1) of the

Member. The Member is not required to designate a branch manager for a sub-branch office who is normally present at the office, provided that a branch manager who is not normally present at such sub-branch office, or a trading partner, director or officer or a compliance officer designated as the branch manager for such sub-branch office, supervises its business at the sub-branch office in accordance with the By-laws and Rules.

- (b) **Responsibilities.** It is the responsibility of a branch manager to:
- (i) ensure that the business conducted on behalf of the Member by an Approved Person and other employees and agents at the branch is in compliance with applicable securities legislation and the By-laws and Rules;
 - (ii) supervise the opening of new accounts and trading activity at the branch office.
- (c) **Alternates.** In the event that a branch manager is temporarily absent or unable to perform his or her responsibilities, a Member shall designate one or more alternate branch managers who must be qualified as branch managers pursuant to Rule 1.2.2(a) and who shall carry out the responsibilities of the branch manager, but are not required to be normally present at the branch office.

2.5.4 **Maintenance of Supervisory Review Documentation.** The Member must maintain records of all compliance and supervisory activities undertaken by it and its partners, directors, officers, compliance officers and branch managers pursuant to the By-laws and Rules.

2.5.5 **No Delegation.** No Member or director, officer, partner, compliance officer, branch manager or alternate branch manager shall be permitted to delegate any supervision or compliance responsibility under the By-laws or Rules in respect of any business of the Member, except as expressly permitted pursuant to the By-laws and Rules.

2.6 **BORROWING FOR SECURITIES PURCHASES**

Each Member shall provide to each client a risk disclosure document containing the information prescribed by the Corporation when

- (a) a new account is opened for the client; and
- (b) when an Approved Person makes a recommendation for purchasing securities by borrowing, or otherwise becomes aware of a client borrowing monies for the purpose of investment,

provided that a Member is not required to comply with paragraph (b) if such a risk disclosure document has been provided to the client by the Member within the six month period prior to such recommendation or becoming so aware.

2.7 **ADVERTISING AND SALES COMMUNICATIONS**

2.7.1 **Definitions.** For the purposes of the By-laws and Rules:

- (a) "advertisement" includes television or radio commercials or commentaries, billboards, internet websites, newspapers and magazine advertisements or

commentaries and any published material promoting the business of a Member and any other sales literature disseminated through the communications media; and

- (b) "sales communication" includes records, video tapes and similar material, market letters, research reports, and all other published material, except preliminary prospectuses and prospectuses, designed for or use in presentation to a client or a prospective client whether such material is given or shown to them and which includes a recommendation in respect of a security.

2.7.2 **General Restrictions.** No Member shall issue to the public, participate in or knowingly allow its name to be used in respect of any advertisement or sales communication in connection with its business which:

- (a) contains any untrue statement or omission of a material fact or is otherwise false or misleading, including the use of a visual image such as a photograph, sketch, drawing, logo or graph which conveys a misleading impression;
- (b) contains an unjustified promise of specific results;
- (c) uses unrepresentative statistics to suggest unwarranted or exaggerated conclusions, or fails to identify the material assumptions made in arriving at these conclusions;
- (d) contains any opinion or forecast of future events which is not clearly labelled as such;
- (e) fails to fairly present the potential risks to the client;
- (f) is detrimental to the interests of the public, the Corporation or its Members; or
- (g) does not comply with any applicable legislation or the guidelines, policies or directives of any regulatory authority having jurisdiction over the Member.

2.7.3 **Review Requirements.** No advertisement or sales communication shall be issued unless first approved by a partner, director, officer, compliance officer or branch manager who has been designated by the Member as being responsible for advertisements and sales communications.

2.8 CLIENT COMMUNICATIONS

2.8.1 **Definition.** For the purposes of the By-laws and Rules "client communication" means any written communication by a Member or an Approved Person to a client of the Member, including trade confirmations and account statements, other than an advertisement or sales communication.

2.8.2 **General Restrictions.** No client communication shall:

- (a) be untrue or misleading or use an image such as a photograph, sketch, logo or graph which conveys a misleading impression;
- (b) make unwarranted or exaggerated claims or conclusions or fail to identify the material assumptions made in arriving at these conclusions;
- (c) be detrimental to the interests of clients, the public, the Corporation or its Members;
- (d) contravene any applicable legislation or any guideline, policy, rule or directive of any regulatory authority having jurisdiction over the Member; or

- (e) be inconsistent or confusing with any information provided by the Member or Approved Person in any notice, statement, confirmation, report, disclosure or other information either required or permitted to be given to the client by a Member or Approved Person under the By-laws, Rules, Policies or Forms.

2.8.3 Rates of Return

- (a) In addition to complying with the requirements in Rule 2.8.2, any client communication containing or referring to a rate of return regarding a specific account or group of accounts must be based on an annualized rate of return and explain the methodology used to calculate such rate of return in sufficient detail and clarity to reasonably permit the client to understand the basis for the rate of return.
- (b) Notwithstanding the provisions of paragraph (a), where an account has been open for less than 12 months, the rate of return shown must be the total rate of return since account opening.

2.9 INTERNAL CONTROLS

Every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time.

2.10 POLICIES AND PROCEDURES MANUAL

Every Member shall establish and maintain written policies and procedures (that have been approved by senior management of the Member) for dealing with clients and ensuring compliance with the Rules, By-laws and Policies of the Corporation and applicable securities legislation.

~~2.11 COMPLAINTS~~

~~Every Member shall maintain a log of client complaints and shall establish written policies and procedures for dealing with client complaints which ensure that such complaints are dealt with promptly and fairly.~~¹⁴

2.12 TRANSFERS OF ACCOUNT

2.12.1 **Definitions.** For the purposes of the By-laws and Rules:

- (a) "account transfer" means the transfer in whole or in part of an account of a client of a Member at the request or with the authority of the client;
- (b) "delivering Member" means in respect of an account transfer the Member from which the account of the client is to be transferred; and
- (c) "receiving Member" means in respect of an account transfer the Member to which the account of the client is to be transferred.

2.12.2 **Transfers.** No account transfer shall be affected by a Member without the written authorization of the client holding the account. If an account transfer is authorized by a client, a delivering Member and a receiving Member shall act diligently and promptly in order to facilitate the transfer of the account in an orderly and timely manner.

¹⁴ Rule not consistent with sections 168.1.1 to 168.1.3 of the Securities Act.

3. RULE NO. 3 - FINANCIAL AND OPERATIONS REQUIREMENTS

3.1 CAPITAL

3.1.1 **Minimum Levels.** Each Member shall have and maintain at all times risk adjusted capital greater than zero, and minimum capital in the amounts referred to below for the Level in which the Member is designated, as calculated in accordance with Form 1 and with such requirements as the Corporation may from time to time prescribe:

Level 1 \$25,000 for a Member which is an introducing dealer and which satisfies the requirements of Rule 1.1.6(a) and (b) and is not a Level 2, 3 or 4 Member.

Level 2 \$50,000 for a Member which does not hold client cash, securities or other property.

Level 3 \$75,000 for a Member which does not hold client securities or other property, except client cash in a trust account.

Level 4 \$200,000, for any other Member, including a Member which acts as a carrying dealer in accordance with Rule 1.1.6.

For the purposes of the By-laws, Rules, Policies and Forms, a Member which is required to maintain minimum capital at an amount referred to above is referred to as a Level 1, 2, 3 or 4 Dealer or Member, as the case may be.

3.1.2 **Notice.** If at any time the risk adjusted capital of a Member is, to the knowledge of the Member, less than zero, the Member shall immediately notify the Corporation.

3.2 CAPITAL AND MARGIN

3.2.1 **Client Lending and Margin.** No Member or Approved Person shall lend or extend credit to a client or permit the purchase of securities by a client on margin, except as provided for in Rule 3.2.3.

3.2.2 **Member Capital.**

(a) Each Member shall maintain capital in respect of its firm business in accordance with the requirements set out in Form 1.

(b) Each Member shall at all times maintain positive total financial statement capital as calculated in accordance with the requirements set out in Form 1.

3.2.3 **Advancing Mutual Fund Redemption Proceeds.** No Member shall advance funds or extend credit to or on behalf of a client, directly or indirectly, in connection with the receipt of funds on the redemption of mutual fund securities unless:

(a) the Member has received prior confirmation of the redemption order from the issuer of the securities;

(b) the redemption proceeds to be received (excluding any fees or commissions) are equal to or greater than the amount of funds or credit to be provided;

(c) the client has authorized payment to and retention by the Member of redemption proceeds;

- (d) the Member maintains a copy of the confirmation of the redemption order and the client's authorization; and
- (e) the Member is designated as being in Level 2, 3 or 4 for the purposes of Rule 3.1.1.

3.2.4 Related Member Guarantees

- (a) Each Member shall be responsible for and shall guarantee the obligations to clients incurred by each of its related Members (as defined in By-law 1), and each related Member shall be responsible for and shall guarantee the obligations of the Member to its clients on the following basis:
 - (i) where a Member holds an ownership interest in a related Member, the Member shall provide a guarantee in an amount equal to 100% of the Member's total financial statement capital (as determined in accordance with Form 1);
 - (ii) where a Member holds an ownership interest in a related Member, the related Member shall provide a guarantee of the Member in an amount equal to the percentage of the related Member's total financial statement capital (as determined in accordance with Form 1) that corresponds to the percentage of ownership interest the Member holds in the related Member; and
 - (iii) where two related Members are related because of a common ownership interest held by the same person(s), each related Member shall provide a guarantee of the other in an amount equal to the percentage of its total financial statement capital (as determined in accordance with Form 1) that corresponds to the percentage ownership interest held by the person(s) who holds the common ownership interest.
- (b) A guarantee shall not be required at all or in the amount prescribed in accordance with Rule 3.2.4(a) where the Corporation in its discretion determines that a guarantee is not appropriate.
- (c) A guarantee shall be required in such greater or lesser amount as prescribed in Rule 3.2.4(a) where the Corporation in its discretion determines that such greater or lesser guarantee amount is appropriate.
- (d) A guarantee required pursuant to this Rule 3.2.4 shall be in the form prescribed from time to time by the Corporation.

3.2.5 Notice Regarding Accelerated Payment of Long Term Debt.

Each Member shall immediately notify the Corporation of any request or demand by a creditor for accelerated payments or any other payments in addition to those specified under the agreed regular repayment schedule with respect to contingent and long term liabilities owed by the Member.

3.3 SEGREGATION OF CLIENT PROPERTY

- 3.3.1 General.** Each Member that holds cash, securities or other property of its clients shall hold such cash, securities or property separate and apart from its own property and in trust for its clients in accordance with this Rule 3.3.

3.3.2 Cash

- (a) **Trust Account.** All cash held by a Member on behalf of clients shall be held separate and apart from the property of the Member in a designated trust account with a financial institution (which is an acceptable institution for the purposes of Form 1).
- (b) **Determination.** Each Member shall determine on a daily basis the amount of cash it holds for clients and that is required to be held in segregation pursuant to this Rule 3.3.
- (c) **Deficiency.** In the event of a deficiency in the amount of cash required to be held in trust for a client, the Member shall immediately provide from its own funds an amount necessary to correct the deficiency and any unsatisfied obligation to do so shall be immediately charged to the capital of the Member.
- (d) **Notice to Institution.** The Member must advise the financial institution in writing that:
 - (i) the account is established for the purpose of holding client funds in trust and the account shall be designated as a "trust account";
 - (ii) money may not be withdrawn, including by way of electronic transfer, by any person other than authorized employees of the Member; and
 - (iii) the money held in trust may not be used to cover shortfalls in any other accounts of the Member.
- (e) **Commingling.** The Member shall not commingle money for mutual fund transactions with money held in trust for the purchase or sale of other securities or financial products (such as deposit instruments or segregated funds). The Member must maintain separate accounts, which may be designated as trust accounts, for the purchase and sale of such other securities or financial products.
- (f) **Interest Bearing.** The trust account bears interest at rates equivalent to comparable accounts of the financial institution.
- (g) **Use of Funds.** The Member shall not use any money received for the investment of mutual funds or other securities to finance its own operations.
- (h) **Distributions.** The Member must have a system in place to properly distribute on a cash basis interest earned in the mutual fund trust account to either the mutual fund companies for reinvestment or to clients directly.

3.3.3 Securities

- (a) **Internal Locations.** For the purposes of Rule 3.3.1, a Member may hold securities or other investment products within the physical possession or control of the Member segregated and held in trust for clients of the Member, provided that all internal storage locations are designated in the Member's ledger of accounts and the Member has adequate internal accounting controls and systems for safeguarding of securities held for clients.
- (b) **External Locations.** For the purposes of Rule 3.3.1, securities or other investment products held beyond the physical possession of the Member must be segregated and held in trust for clients of a Member, or segregated and held by or for a Member,

as the case may be, in acceptable securities locations, provided that the written terms upon which such securities or other investment products are deposited and held beyond the physical possession of the Member include provisions to the effect that:

- (i) no use or disposition of the securities or products shall be made without the prior written consent of the Member;
 - (ii) certificates representing the securities or products can be delivered to the Member promptly on demand or, where certificates are not available and the securities are represented by book entry at the location, the securities or products can be transferred either from the location or to another person at the location promptly on demand; and
 - (iii) the securities or products are held in segregation for the Member or its clients free and clear of any charge, lien, claim or encumbrance of any kind in favour of the depository or institution holding such securities or products.
- (c) **Bulk Segregation.** A Member, which holds securities or property of clients in segregation in accordance with Rule 3.3.1 may hold securities or property in bulk segregation provided that the Member identifies in its records the amount and kind of each security or property held for each client. The Member shall determine, for all accounts of each client the market value and number of all securities to be held for the client.
- (d) **General Restrictions.** In complying with its obligation to segregate client securities in accordance with Rule 3.3.1, each Member shall ensure that:
- (i) a segregation deficiency is not knowingly created or increased; and
 - (ii) all securities of clients received by the Member are segregated.
- (e) **Correction of Segregation Deficiencies.** In the event that a segregation deficiency exists, the Member shall expeditiously take the most appropriate action required to settle the segregation deficiency. If for any reason the deficiency has not been settled within 30 days of being discovered, the Member shall immediately purchase the securities or property for the account of the client.

3.4 EARLY WARNING

3.4.1 **Definitions.** The terms and definitions used in this Rule 3.4 shall have the same meanings as used in Form 1, unless otherwise defined in the By-laws or Rules or the context requires.

3.4.2 (a) **Designation.** A Member shall be designated in early warning according to its capital, profitability and liquidity position from time to time and frequency of designation or at the discretion of Corporation as provided in this Rule 3.4 if at any time:

- (i) *Capital*
Its risk adjusted capital is less than zero; or
- (ii) *Liquidity*
Its early warning excess is less than zero; or
- (iii) *Profitability*

Its risk adjusted capital at the time of calculation is less than the net loss (before bonuses, income taxes and extraordinary items) for the most recent quarter.

(iv) *Frequency*

It has been designated in early warning more than two times in the preceding twelve months.

(v) *Discretionary*

The condition of the Member, in the sole discretion of the Corporation, is not satisfactory for any reason including, without limitation, financial or operating difficulties, problems arising from record keeping conversion or significant changes in clearing methods, the fact that the Member is a new Member or the Member has been late in any filing or reporting required pursuant to the By-laws and Rules.

(b) **Requirements.** If a Member is designated in early warning then, notwithstanding the provisions of any By-law or Rule, the following provisions shall apply:

(i) the chief executive officer and chief financial officer of the Member shall immediately deliver to the Corporation a letter containing the following:

(A) advice of the fact that any of the circumstances in Rule 3.4.2 are applicable,

(B) an outline of the problems associated with the circumstances referred to in (A),

(C) an outline of the proposal of the Member to rectify the problems identified, and

(D) an acknowledgement that the Member is in early warning category and that the restrictions contained in Rule 3.4.2(b)(iv) apply,

a copy of which letter shall be provided to the Member's auditor;

(ii) the Corporation shall immediately designate the Member as being in early warning and shall deliver to the chief executive officer and chief financial officer a letter containing the following:

(A) advice that the Member is designated as being in early warning,

(B) a request that the Member file its next monthly financial report required pursuant to Rule 3.5.1(a) no later than 15 business days or, in the discretion of the Corporation if considered to be practicable, such earlier time following the end of the relevant month,

(C) a request that the Member respond to the letter as required under Rule 3.4.2(b)(iii) and confirmation that such response, together with the notice received pursuant to Rule 3.4.2(b)(i), will be forwarded to MFDA Investor Protection Corporation and may be forwarded to any securities commission having jurisdiction over the Member,

(D) advice that the restrictions referred to in Rule 3.4.2(b)(iv) shall apply to the Member,

- (E) such other information as the Corporation shall consider relevant;
 - (iii) the chief executive officer and the chief financial officer of the Member shall respond by letter signed by them both within five business days of receipt of the letter referred to in Rule 3.4.2(b)(ii), with a copy to be sent to the auditor of the Member, containing the information and acknowledgement required pursuant to Rule 3.4.2(b)(i)(B), (C) and (D), to the extent not previously provided, or an update of such information if any material circumstances or facts have changed;
 - (iv) if and so long as the Member remains designated as being in early warning, it shall not without the prior written consent of the Corporation:
 - (A) reduce its capital in any manner including by redemption, re-purchase or cancellation of any of its shares,
 - (B) reduce or repay any indebtedness which has been subordinated with the approval of the Corporation,
 - (C) directly or indirectly make any payments by way of loan, advance, bonus, dividend, repayment of capital or other distribution of assets to any director, officer, partner, shareholder, related company, affiliate or associate,
 - (D) increase its non-allowable assets (as specified by the Corporation) unless a prior binding commitment to do so exists or enter into any new commitments which would have the effect of materially increasing the non-allowable assets of the Member,
 - (v) if and so long as the Member remains designated as being in early warning, it shall continue to file its monthly financial reports within the time specified pursuant to Rule 3.4.2(b)(ii)(B),
 - (vi) after the Member is designated as being in an early warning category, the Corporation may conduct an on-site review of the Member's procedures for monitoring capital on a daily basis and prepare a report as to the results of the review, or
 - (vii) the Corporation may request and the Member shall provide in such time as the Corporation considers practicable, such reports or information, on a daily or a less frequent basis, as may be necessary or desirable in the opinion of the Corporation to assess and monitor the financial condition or operations of the Member.
- (c) **Prohibited Transactions.** No Member shall enter into any transaction or take any action, as described in Rule 3.4.2(b)(iv), which, when completed, would have or would reasonably be expected to have the effect on the Member as described in Rule 3.4.2(a), without first notifying the Corporation in writing of its intention to do so and receiving the written approval of the Corporation prior to implementing such transaction or action.

3.4.3 **Restrictions.** The Corporation may in its discretion, without affording the Member a hearing, prohibit a Member which is designated as being in early warning from opening any new branch offices, hiring any new Approved Persons, opening any new client accounts or changing in any material respect the investment positions of the Member. Any such prohibitions which have been imposed shall continue to apply until the Member

is no longer designated as being in early warning, as demonstrated by the latest filed monthly financial report of the Member.

- 3.4.4 **Duration.** A Member shall remain designated as being in early warning and subject to the provisions in this Rule 3.4 as are applicable, until the latest filed monthly financial reports of the Member, or such other evidence or assurances as may be appropriate in the circumstances demonstrate, in the opinion of the Corporation that the Member no longer is required to be designated as being in early warning and the Member has otherwise complied with this Rule 3.4.

3.5 **FILING REQUIREMENTS**

- 3.5.1 **Monthly and Annual.** Each Member shall:

- (a) file monthly with the Corporation within 20 business days of the month's end a copy of a financial report of the Member as at the end of each fiscal month or at such other date as may be agreed with the Corporation. Such monthly financial reports shall contain or be accompanied by such information as may be prescribed by the Corporation from time to time; and
- (b) file annually with the Corporation two copies of the audited financial statements of the Member as at the end of the Member's fiscal year or as at such other fixed date as may be agreed with the Corporation. Such statements shall be in such form, shall contain such information and shall be supplemented by such additional schedules as the Corporation may from time to time prescribe, and shall be filed through the Member's auditor within 90 days of the date as of which such statements are required to be prepared;

- 3.5.2 **Combined Financial Statements.** In calculating the risk adjusted capital of a Member, the financial position of the Member may, with the prior approval of the Corporation, be combined (in a manner as set out below) with that of any related Member provided that:

- (a) the Member has guaranteed the obligations of such related Member and the related Member has guaranteed the obligations of the Member (such guarantee to be in a form acceptable to the Corporation and unlimited in amount).
- (b) inter-company accounts between the Member and the related Member shall be eliminated;
- (c) any minority interests in the related Member shall be eliminated from the capital calculation; and
- (d) calculations with respect to the Member and the related Member shall be as of the same date.

- 3.5.3 **Members' Auditors**

- (a) **Examination.** Every Member's auditor shall examine the accounts of the Member as at the date referred to in Rule 3.5.1 and shall make a report thereon in such form as the Corporation may from time to time prescribe. Each Member's auditor shall also make such additional examinations and reports as the Corporation may from time to time request or direct.
- (b) **Standards.** The Member's auditor shall conduct his or her examination of the accounts of the Member in accordance with Canadian generally accepted auditing standards and the scope of his or her procedures shall be sufficiently extensive to

permit him or her to express an opinion on the Member's financial statements in the form prescribed. Without limiting the generality of the foregoing, the scope of the examination shall, where applicable, include at least the procedures set out in Rule 3.6.

- (c) **Access to Books and Records.** Every Member's auditor for the purpose of any documents, bank accounts, vouchers, correspondence and records of every description of the Member being examined or its affiliates or its related Members, and no Member, affiliate or related company, as the case may be, shall withhold, destroy or conceal any information, document or thing reasonably required by the Member's auditor for the purpose of such examination.

~~3.5.4—Assessments~~

- ~~(a) **Excessive Attention.** If at any time the Corporation is of the opinion that the financial condition or conduct of the business of any Member has required excessive attention from the Corporation and that it would be in the interests of the Corporation that the Corporation be reimbursed by such Member, the Corporation shall have the power to impose an assessment against such Member.~~
- ~~(b) **Late Filing.** Each Member shall be liable for and pay to the Corporation levies or assessments in the amounts prescribed from time to time by the Corporation for the failure of the Member, its auditors or any person acting on its behalf, to file any report, form, financial statement or other information required under this Rule 3 within the times prescribed by this Rule 3, the Corporation or the terms of such report, form, financial statement or other information, as the case may be.~~¹⁵

3.6 AUDIT REQUIREMENTS

3.6.1 **Standards.** The audit under Rule 3.5 shall be conducted in accordance with Canadian generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding assets. It shall include all audit procedures necessary under the circumstances to support the opinions which must be expressed in the Member's auditor's reports of Parts I and II of Form 1. Because of the nature of the industry, the substantive audit procedures relating to the financial position must be carried out as of the audit date and not as of an earlier date, notwithstanding that the audit is otherwise conducted in accordance with Canadian generally accepted auditing standards.

3.6.2 **Scope**

- (a) *Tests.* The scope of the audit shall include the following procedures, but nothing herein shall be construed as limiting the audit or permitting the omission of any additional audit procedure which any Member's auditor would deem necessary under the circumstances. For purposes of this Rule tests fall into two basic categories (as described in CICA Handbook):
- (i) specific item tests, whereby the auditor examines individual items which he or she considers should be examined because of their size, nature or method of recording; and
 - (ii) representative item tests, whereby the auditor's objective is to examine an unbiased selection of items.

¹⁵ Rule not consistent as all fees applicable to a dealer must be established within the Quebec regulations pertaining to fees.

The determination of an appropriate sample on a representative basis may be made using either statistical or non-statistical methods in accordance with Canadian generally accepted auditing standards.

In determining the extent of the tests appropriate in sub-sections (i), (ii) and (iii) of (b) below, the Member's auditor should consider the adequacy of the system of internal control and the level of materiality appropriate in the circumstances so that in the auditor's professional judgement the risk of not detecting a material misstatement, whether individually or in aggregate is reduced to an appropriately low level (e.g. in relation to the estimated risk adjusted capital and early warning excess).

- (b) *Audit Procedures.* The Member's auditor shall as of the audit date:
- (i) compare ledger accounts with the trial balances obtained from the general and subsidiary ledgers and substantiate the subsidiary ledger totals with their respective control accounts (see Rule 3.6.4 below relating to Electronic Data Processing);
 - (ii) account for, by physical examination and comparison with the books and records, all securities in the physical possession of the Member;
 - (iii) review the reconciliation of all mutual fund companies and financial institutions where a Member operates a nominee name account and review the balancing of all positions. Where a position or account is not in balance according to the records, ascertain that an adequate provision has been made in accordance with the Notes and Instructions for out of balance positions embodied in Statement B of Form 1 for any potential loss;
 - (iv) review bank reconciliations and by appropriate audit procedures substantiate on a test basis the reconciliations with the ledger control accounts as of the audit date;
 - (v) where a Member operates a nominee name account or has its own securities or investment products, ensure that all custodial agreements are in place for those lodged with acceptable locations and that such agreements satisfy the minimum requirements of the Corporation;
 - (vi) obtain written confirmation with respect to the following:
 - (A) bank balances and other deposits;
 - (B) cash, nominee name positions and deposits with clearing houses and like organizations and cash and nominee name positions with mutual fund companies and financial institutions;
 - (C) cash and investments loaned or borrowed (including subordinated loans) together with details of collateral received or pledged, if any;
 - (D) accounts with brokers or dealers;
 - (E) accounts of directors, partners or officers of the Member held by the Member where the Member operates a nominee name account;

- (F) accounts of clients where a Member operates a nominee name account;
- (G) statements from the Member's lawyers as to the status of lawsuits and other legal matters pending which, if possible, should include an estimate of the extent of the liabilities so disclosed; and
- (H) all other accounts which in the opinion of the Member's Auditor should be confirmed.

Compliance with the confirmation requirements shall be deemed to have been made if positive requests for confirmation have been sent by, and returned directly to, the Member's auditor and second requests are similarly sent to those not replying to the initial request. Appropriate alternative verification procedures must be used where replies to second requests have not been received. For accounts mentioned in (D) and (F) above, the Member's auditor shall (1) select specific accounts for positive confirmation based on their size (all accounts with equity exceeding a certain monetary amount, with such amount being related to the level of materiality) and other characteristics such as accounts in dispute, and (2) select a representative sample from all other accounts of sufficient extent to provide reasonable assurance that a material error, if it exists, will be detected. For accounts in (D) and (F) above that are not confirmed positively, the Member's auditor shall send statements with a request that any differences be reported directly to the auditor. Clients' accounts without any balance whatsoever and those closed since the last audit date shall also be confirmed on a test basis using either positive or negative confirmation procedures, the extent to be governed by the adequacy of the system of internal control;

- (vii) subject the Statements in Part I and Schedules in Part II of Form 1 to audit tests and/or other auditing procedures to determine that the margin and capital requirements, which are used in the determination of the excess (deficiency) of risk adjusted capital are calculated in accordance with the Rules and Form 1 in all material respects in relation to the financial statements taken as a whole;
- (viii) obtain a letter of representation from the senior officers of the Member with respect to the fairness of the financial statements including among other things the existence of contingent assets, liabilities and commitments.
- (ix) complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Segregation of Cash and Securities in Form 1.

3.6.3 Additional Reporting. In addition, the Member's auditor shall:

- (a) complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Insurance in Form 1; and
- (b) report on any subsequent events, to date of filing, which have had a material adverse effect on the excess (deficiency) of risk adjusted capital.

- 3.6.4 **Systems Review.** The Member's auditors' review of the accounting system, the internal accounting control and procedures for safeguarding securities prescribed in the above Audit Requirements should encompass any in-house or service bureau EDP operations. As a result of such review and evaluation the Member's auditor may be able to reduce the extent of detailed checking of clients and other account statements to trial balances and security position records.
- 3.6.5 **Retention.** Copies of Form 1 and all audit working papers shall be retained by the Member's auditor for seven years. The two most recent years shall be kept in a readily accessible location. All working papers shall be made available for review by the Corporation and the MFDA Investor Protection Corporation and the Member shall direct its auditor to provide such access on request.
- 3.6.6 **Report to Corporation.** If the Member's auditor observes during the regular conduct of his or her audit any material breach of the By-laws or Rules pertaining to the calculation of the Member's financial position, handling and custody of securities and maintenance of adequate records he or she shall make a report to the Corporation.
- 3.6.7 **Reliance.** The reports and audit opinions required in respect of a Member under this Rule 3.6 shall be addressed to the Corporation and the MFDA Investor Protection Corporation in conjunction with the Member who shall be entitled to rely on them for all purposes.
- 3.6.8 **Qualification.** The reports and audit opinions referred to in this Rule 3.6 shall be signed by an engagement partner on behalf of the Member's auditor who shall (i) be authorized to do so in accordance with applicable legislation in the jurisdiction in which the principal office of the Member is located, (ii) be acceptable to the Corporation in accordance with By-law 11.2.1, and (iii) have acknowledged in writing to the Corporation and the Member that it is familiar with the then current By-laws, Rules, Policies and Forms as they relate to the matters required to be reported on therein.

~~4. — RULE NO. 4 — INSURANCE~~

~~4.1 FINANCIAL INSTITUTION BOND~~

~~Every Member shall, by means of a Financial Institution Bond or Bonds (with Discovery Rider attached or Discovery Provisions incorporated in the Bond) and/or mail insurance, effect and keep in force insurance against losses arising as follows:~~

~~**Clause (A) — Fidelity** — Any loss through any dishonest or fraudulent act of any of its employees or agents, committed anywhere and whether committed alone or in collusion with others, including loss of property through any such act of any of the employees;~~

~~**Clause (B) — On Premises** — Any loss of cash and securities or other property through robbery, burglary, theft, hold-up or other fraudulent means, mysterious disappearance, damage or destruction while within any of the insured's offices, the offices of any banking institution or clearing house or within any recognized place of safe deposit, as more fully defined in the Standard Form of Financial Institution Bond (herein referred to as the "Standard Form");~~

~~**Clause (C) — In Transit and Mail** — Any loss of cash and securities or other property through robbery, burglary, theft, hold-up, misplacement, mysterious disappearance, damage or destruction, while in transit or in the mail;~~

~~**Clause (D) — Forgery or Alterations** — Any loss through forgery or alteration of any cheques, drafts, promissory notes or other written orders or directions to pay sums in cash, excluding securities, as more fully defined in the Standard Form;~~

~~**Clause (E) — Securities** — Any loss through having purchased or acquired, sold or delivered, or acted upon securities or other written instruments which prove to have been forged, counterfeited, raised or altered, or lost or stolen, or through having guaranteed in writing or witnessed any signatures upon any transfers, assignments or other documents or written instruments, as more fully defined in the Standard Form.~~

~~A Member is not required to effect and keep in force mail insurance where the Member does not use mail for outgoing shipments of cash, securities or other property, negotiable or non-negotiable.~~

~~4.2 — NOTICE OF TERMINATION~~

~~Each Financial Institution Bond maintained by a Member shall contain a rider containing provisions to the following effect:~~

~~(i) — The underwriter shall notify the Corporation at least 30 days prior to the termination or cancellation of the Bond, except in the event of termination of the Bond due to:~~

~~(A) the expiration of the Bond period specified;~~

~~(B) cancellation of the Bond as a result of the receipt of written notice from the insured of its desire to cancel the Bond;~~

~~(C) the taking over of the insured by a receiver or other liquidator, or by provincial, federal or state officials; or~~

~~(D) taking over of the insured by another institution or entity.~~

- ~~(ii) In the event of termination of the Bond as an entirety in accordance with clauses (i)(B), (i)(C) or (i)(D), the underwriter shall, upon becoming aware of such termination, give immediate written notice of the termination to the Corporation. Such notice shall not impair or delay the effectiveness of the termination.~~

~~4.3 — TERMINATION OR CANCELLATION~~

~~In the event of the take-over of a Member by another institution or entity as described in Rule 4.2(D) the Member shall ensure that there is bond coverage which provides a period of twelve months from the date of such take-over within which to discover the losses, if any, sustained by the Member prior to the effective date of such take-over and the Member shall pay, or cause to be paid, any applicable additional premium.~~

~~4.4 — AMOUNTS REQUIRED~~

~~4.4.1 — **Minimum.** The minimum amount of insurance to be maintained for each Clause under Rule 4.1 shall be the greater of:~~

- ~~(a) in the case of a Member designated as a Level 1, 2 or 3 Dealer, \$50,000 for each Approved Person up to a maximum of \$200,000; and for a Level 4 Dealer, \$500,000; and~~

- ~~(b) 1% of the base amount (as defined herein);~~

~~provided that for each Clause such minimum amount need not exceed \$25,000,000.~~

~~4.4.2 — **Base Amount.** For the purposes of this Rule 4.4, the term "base amount" shall mean the greater of:~~

- ~~(a) the net value of cash and securities held by the Member on behalf of clients; and~~
- ~~(b) the total allowable assets of the Member determined in accordance with Statement A of Form 1.~~

~~4.5 — PROVISOS~~

~~Rules 4.1, 4.2 and 4.4 shall be subject to the following:~~

- ~~(a) the amount of insurance required to be maintained by a Member shall as a minimum be by way of a Financial Institution Bond with a double aggregate limit or a provision for full reinstatement;~~
- ~~(b) should there be insufficient coverage, a Member shall be deemed to be complying with this Rule 4 provided that any such deficiency does not exceed 10 percent of the insurance requirement and that evidence is furnished within two months of the dates of completion of the monthly operations questionnaires and the annual audit that the deficiency has been corrected. If the deficiency is 10% or more of the insurance requirement, action must be taken by the Member to correct the deficiency within 10 days of its determination and the Member shall immediately notify the Corporation;~~
- ~~(c) a Financial Institution Bond maintained pursuant to Rule 4.1 may contain a clause or rider stating that all claims made under the bond are subject to a deductible.~~

~~4.6 — QUALIFIED CARRIERS~~

~~Insurance required to be effected and kept in force by a Member pursuant to this Rule 4 may be underwritten directly by either (i) an insurer registered or licensed under the laws of Canada or any province of Canada or (ii) any foreign insurer approved by the Corporation. No foreign insurer shall be approved by the Corporation unless the insurer has the minimum net worth required of \$75 million on the last audited balance sheet, provided acceptable financial information with respect to such corporation is available for inspection and the Corporation is satisfied that the insurer is subject to supervision by regulatory authorities in the jurisdiction of incorporation of the insurer which is substantially similar to the supervision of insurance companies in Canada.~~

~~4.7 GLOBAL FINANCIAL INSTITUTION BONDS~~

~~Where the insurance maintained by a Member in respect of any of the requirements under this Rule 4 names as the insured or benefits the Member, together with any other person or group of persons, whether within Canada or elsewhere, the following must apply:~~

- ~~(a) the Member shall have the right to claim directly against the insurer in respect of losses, and any payment or satisfaction of such losses shall be made directly to the Member; and~~
- ~~(b) the individual or aggregate limits under the policy may only be affected by claims made by or on behalf of
 - ~~(i) the Member, or~~
 - ~~(ii) any of the Member's subsidiaries whose financial results are consolidated with those of the Member, or~~
 - ~~(iii) a holding company of the Member provided that the holding company does not carry on any business or own any investments other than its interest in the Member,~~~~

~~without regard to the claims, experience or any other factor referable to any other person.~~

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¹⁶ Rules not consistent with the Quebec mutual fund dealer liability insurance regime established in sections 193, 194 and 195 of the Securities Regulations.

5. RULE NO. 5 - BOOKS, RECORDS & REPORTING

5.1 REQUIREMENT FOR RECORDS

Every Member shall keep such books, records and other documents as are necessary for the proper recording of its business transactions and financial affairs and the transactions that it executes on behalf of others and shall keep such other books, records and documents as may be otherwise required by the Corporation. Such books and records shall contain as a minimum the following:

- (a) blotters, or other records, containing an itemized daily record of:
 - (i) all purchases and sales of securities;
 - (ii) all receipts and deliveries of securities, including certificate numbers;
 - (iii) all receipts and disbursements of cash;
 - (iv) all other debits and credits, the account for which each transaction was effected;
 - (v) the name of the securities;
 - (vi) the class or designation of the securities;
 - (vii) the number or value of the securities;
 - (viii) the unit and aggregate purchase or sale price; and
 - (ix) the trade date and the name or other designation of the person from whom the securities were purchased or received or to whom they were sold or delivered;
- (b) an adequate record of each order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such record shall show:
 - (i) the terms and conditions of the order or instructions and of any modification or cancellation thereof;
 - (ii) the account for which entered or received; and
 - (iii) the time of entry or receipt, the price at which executed and, to the extent feasible, the time of execution or cancellation;
- (c) where the order or instruction is placed by an individual other than the person in whose name the account is operated, or an individual duly authorized to place orders or instructions on behalf of a client that is a company, the name, sales number or designation or the individual placing the order or instruction shall be recorded;
- (d) copies of confirmations of all purchases and sales of securities and copies of all other debits and credits for securities, cash and other items for the account of clients;

- (e) a record of the proof of cash balances of all ledger accounts in the form of trial balances and a record of calculation of minimum capital, adjusted liabilities and risk adjusted capital required;
- (f) all cheque books, bank statements, cancelled cheques and cash reconciliations;
- (g) all bills receivable or payable (or copies thereof), paid or unpaid, relating to the business of the Member;
- (h) all limited trading authorizations in respect of any account, and copies of resolutions empowering an agent to act on behalf of a corporation;
- (i) all written agreements (or copies thereof) entered into by such Member relating to their business as such, including leveraging documentation, disclosure materials and agreements relating to any account; and
- (j) all documentation relating to an advance of funds or extension of credit to or on behalf of a client, directly or indirectly, in connection with the receipt of funds on the redemption of mutual fund securities, including the prior written confirmation referred to in Rule 3.2.3.

5.2 STORAGE MEDIUM

All records and documents required to be maintained by a Member in writing or otherwise may be kept by means of mechanical, electrical, electronic or other devices provided:

- (a) such method of record keeping is not prohibited under any applicable legislation;
- (b) there are appropriate internal controls in place, to guard against the risk of falsification of the information recorded;
- (c) such method provides a means to furnish promptly to the Corporation upon request legible, true and complete copies of those records of the Member which are required to be preserved; and
- (d) the Member has suitable back-up and disaster recovery programs.

5.3 CLIENT REPORTING

5.3.1 Delivery of Account Statement

- (a) Each Member shall send an account statement to each client in accordance with the following minimum standards:
 - (i) once every 12 months for a client name account;
 - (ii) once a month for nominee name accounts of clients where there is an entry during the month and a cash balance or security position; and
 - (iii) quarterly for nominee name accounts where no entry has occurred in the account and there is a cash balance or security position at the end of the quarter.
- (b) A Member may not rely on any other person (including an Approved Person) to send account statements as required by this Rule.

- (c) Notwithstanding the provisions of 5.3.1(b), a Member may rely on the trustee administering a self-directed registered plan to send the account statement required by paragraph (a)(i) where the following conditions are met:
 - (i) The Member does not act as agent for the trustee for the registered plans;
 - (ii) The trustee meets the definition of "Acceptable Institution" as defined in Form 1;
 - (iii) There is a services agreement in place between the Member and the trustee which complies with the requirements of MFDA Rule 1.1.3 and provides that the trustee is responsible for sending account statements to clients of the Member that comply with the requirements of MFDA Rule 5;
 - (iv) There is clear disclosure about which trades are placed by the Member;
 - (v) Clear disclosure must be provided on the account statement regarding which securities positions referred to on the statement are eligible for coverage by the MFDA Investor Protection Corporation and which are not (once the Corporation is offering coverage);
 - (vi) The Member's full legal name must appear on the account statement together with the name of the trustee; and
 - (vii) The Member must receive copies of the statements to ensure that the information contained therein matches its own information regarding the transactions it executes.
- (d) Notwithstanding the provisions of Rule 5.3.1(b), where a Member is affiliated with a fund manager and in connection with a specific client account is selling only the mutual fund securities of an issuer managed by such affiliated fund manager for that client account, the Member may rely on the affiliated fund manager to send the account statement required by paragraph (a)(i) for that specific account.

5.3.2 **Automatic Payment Plans.** Notwithstanding the provisions of Rule 5.3.1 (a)(ii), where a Member holds client assets in nominee name and the only entry in the client's account in a month relates to the client's participation in:

- (a) any automatic payment plan that provides for systematic trading in the securities of a mutual fund on a monthly or more frequent basis, or
- (b) other automatic entries such as dividends and reinvested distributions,

the Member shall send an account statement to the client quarterly.

5.3.3 **Content of Account Statement.** Each account statement must contain the following information:

- (a) for nominee name accounts or accounts where the Member acts as an agent for the trustee for the purposes of administering a self-directed registered retirement savings or similar plan:
 - (i) the opening balance;
 - (ii) all debits and credits;

- (iii) the closing balance;
 - (iv) the quantity and description of each security purchased, sold or transferred and the dates of each transaction, and;
 - (v) the quantity, description and market value of each security position held for the account;
- (b) for client name accounts:
- (i) all debits and credits;
 - (ii) the quantity and description of each security purchased, sold or transferred and the dates of each transaction; and
 - (iii) for automatic payment plan transactions, the date the plan was initiated, a description of the security and the initial payment amount made under the plan.
- (c) for all accounts:
- (i) the type of account;
 - (ii) the account number;
 - (iii) the date the statement was issued;
 - (iv) the period covered by the statement;
 - (v) the name of the Approved Person(s) servicing the account, if applicable; and
 - (vi) the name, address and telephone number of the Member.

5.3.4 **Member Business Only.** Only transactions executed by the Member may appear on the statement of account required pursuant to Rule 5.3.3.

5.4 TRADE CONFIRMATIONS

5.4.1 **Delivery of Confirmations.** Every Member who has acted as principal or agent in connection with any trade in a security shall promptly send by prepaid mail or deliver to the client a written confirmation of the transaction containing the information required under Rule 5.4.3. The Member need not send to its client a written confirmation of a trade in a security of a mutual fund where the manager of the mutual fund sends the client a written confirmation containing the information required to be sent under Rule 5.4.3.

5.4.2 **Automatic Payment Plans.** Where a transaction relates to a client's participation in an automatic payment plan that provides for systematic trading in the securities of a mutual fund on a monthly or more frequent basis, and the Member registers the mutual funds pursuant to the plan, the Member is required to send a trade confirmation for the initial purchase only.

5.4.3 **Content.** Every confirmation of trade sent to a client must set forth the following information:

- (a) the quantity and description of the security;
- (b) the price per share or unit at which the trade was effected;
- (c) the consideration;
- (d) the name of the Member;
- (e) whether or not the Member is acting as principal or agent;
- (f) if acting as agent, the name of the person or company from or to or through whom the security was bought or sold;
- (g) the type of the account through which the trade was effected;
- (h) the commission, if any, charged in respect of the trade;
- (i) the amount deducted by way of sales, service and other charges;
- (j) the amount, if any, of deferred sales charges;
- (k) the name of the Approved Person, if any, in the transaction;
- (l) the date of the trade; and
- (m) the settlement date.

5.5 ACCESS TO BOOKS AND RECORDS

All books, records, documentation and other information required to be kept and maintained by a Member or Approved Person shall be available for review by the Corporation and the Corporation shall be entitled to make copies thereof and retain them for the purposes of carrying out its objects and responsibilities under the applicable securities legislation, the By-laws or the Rules.

5.6 RECORD RETENTION

Each Member shall retain copies of the records and documentation referred to in this Rule 5 for seven years or such other time as may be prescribed by the Corporation.

MFDA POLICY NO. 1

NEW REGISTRANT ~~TRAINING AND~~¹⁷ SUPERVISION

Introduction

This Policy provides guidance on how to comply with MFDA Rule 1.2.1(c) which requires all Members to develop and document a ~~training and~~ supervision program for their newly-registered salespersons. With respect to supervision, this Policy sets out standards for new registrants that are in addition to the supervision requirements set out in MFDA Policy No.2 entitled “Minimum Standards for Account Supervision”, that apply to all salespersons.

~~Training Program~~

~~MFDA Rule 1.2.1(c) requires all newly registered salespersons to complete a training program within 90 days of being registered with the relevant provincial securities commission.~~

~~A Member's training program should cover, at a minimum, the following topics:~~

~~General Knowledge: provide an overview of the Member and the industry and cover the salesperson's role, including the range of permitted activities under the salesperson's license.~~

~~Product Knowledge: provide a detailed orientation of the product lines offered by the Member.~~

~~Advising the Client: review the practical skills required to obtain and interpret know-your-client information to ensure “suitability” obligations have been met and appropriate asset allocation is achieved for clients.~~

~~Administration: provide an understanding of internal systems and technology, processes and controls and record keeping.~~

~~Sales Process: review client communications, including sales skills and marketing. Review disclosure requirements, transaction documentation requirements, compensation policies and approval processes.~~

~~Ethics and Standards of Conduct: provide an understanding of acceptable and non-acceptable business practices, review compliance policies, procedures and regulatory requirements, including sales practice procedures required under securities legislation, including National Instrument 81-105.~~

~~For salespersons transferring from one Member to another, it will be incumbent upon the receiving Member to ensure that the training program was completed with the prior Member.~~

Supervision Policy

MFDA Rule 1.2.1(c) requires that all newly registered salespersons be subject to concurrent supervision by the Member for a period of 6 months, commencing on the date of initial registration. Such supervision should include at a minimum:

The first 90 day period:

¹⁷ The part of Policy No. 1 pertaining to the training program is not consistent with the *Regulation of the Chambre de la sécurité financière respecting compulsory professional development* applicable to mutual fund representatives registered with the Autorité des marchés financiers.

- a) all new accounts must be pre-approved by the Branch Manager prior to any trade being processed in the account;
- b) all trading activity must be reviewed and signed off by the Branch Manager no later than one business day following the trade date; and
- c) all leveraged trades where leveraging was recommended by the Member's salesperson must be reviewed by the Branch Manager prior to trade execution.

The subsequent 90 day period:

- a) all new accounts must be pre-approved by the Branch Manager prior to or shortly after (within 1 business day) any trade being processed in the account;
- b) each month, the Branch Manager must review the greater of:
 - (i) 5 of the client files that were handled by the salesperson in the preceding one month, and
 - (ii) 10% of such client files,provided that if the number of such client files is less than 5, then the Branch Manager must review the actual number of such client files;
- c) on a daily basis, the Branch Manager must review the greater of:
 - (i) 5 of the trades conducted by the salesperson, and
 - (ii) 10% of such trades,provided that if the number of such trades is less than 5, then the Branch Manager must review the actual number of such trades, (high-risk trades, are to be given particular attention); and
- d) all leveraged trades where leveraging was recommended by the Member's salesperson must be reviewed by the Branch Manager prior to trade execution.

In reviewing client files, the Branch Manager should ensure that: the proper documentation is contained in the files, including a New Account Application Form; all information is complete, such as the know-your-client information; and look for any unusual information, such as signed blank forms. If the New Account Application Form does not include know-your-client information, this must be documented on a separate form.

All supervisory activities with regard to newly-registered salespersons should be documented and kept on file at the branch location. Refer to the report attached to this Policy which is to be completed by the relevant supervisor at the end of the training and supervision program. Further, any compliance issues that required action on the part of the Branch Manager or other compliance staff must be documented and kept on file.

It is expected that when a salesperson is unsuccessful in meeting a Member's expectations, the supervision ~~and training~~ period will be extended accordingly until such time as the Member is satisfied that the salesperson no longer needs to be subject to internal supervision. Any extensions should be documented accordingly.

**CONFIRMATION OF COMPLETION OF NEW REGISTRANT
TRAINING AND SUPERVISION PROGRAM**

I _____ hereby certify that I have supervised _____
(branch manager) (salesperson's name)

from the period ____/____/____ to ____/____/____ in accordance with the requirements in
(dd / mm / yy) (dd / mm / yy)

MFDA Rule 1.2.1(c) and the MFDA New Registrant ~~Training and~~ Supervision Policy and confirm that the following information is true and correct to the best of my knowledge:

- ~~1. The salesperson designated above has completed the firm's training program within 90 days of being registered with the applicable provincial securities commission.~~
2. I (or an alternate) have approved all new accounts opened by the above salesperson prior to a first trade in such accounts within his/her first 90 days of registration.
3. I (or an alternate) have reviewed and approved all trading activity by the salesperson within his/her first 90 days of registration.
4. I have reviewed all leveraged trades executed through the above salesperson where leveraging was recommended by the above salesperson prior to completion of the transaction.
5. For each month for the 90 day period following the salesperson's first 90 days of registration I have reviewed the greater of (i) 5 of the salesperson's client files and (ii) 10 percent of the salesperson's client files; or if the number of the salesperson's client files is less than 5, I have reviewed the actual number of such client files.
6. On a daily basis for the 90 day period following the salesperson's first 90 days of registration I have reviewed the greater of (i) 5 of the salesperson's trades and (ii) 10 percent of the salesperson's trades; or if the number of the salesperson's trades is less than 5, I have reviewed the actual number of the salesperson's trades.
7. Any client complaints concerning the above salesperson have been reviewed and discussed with the above salesperson and written documentation has been maintained in the file for any compliance issues that required action.

IF ITEM 7 IS APPLICABLE, COMPLETE ITEM 8 BY CROSSING OUT THE PARAGRAPH THAT DOES NOT APPLY:

8. (i) As a result of the complaints received, the above salesperson's supervisory period has been extended by ____ months; or

(ii) The complaints were resolved to my satisfaction and it was not necessary to extend the above

Date

Signature of Branch Manager

Name of Branch Manager

Name of Member

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.

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 to perform them and should be advised in writing of their duties.

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 Salesperson Training and Supervision Policy."
3. Information contained in compliance-related bulletins from the MFDA and 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 must be clearly detailed in the Member's written procedures.

II. Opening New Accounts

To comply with the "Know-Your-Client" requirements set out in Section 2 of the MFDA Rules, 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

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.
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.

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 Master Files

1. Entering and amending client master files must be controlled and accompanied by proper documentation.
2. 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. 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. 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 must be reviewed and approved 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 unusual trading activity using any convenient means. This review 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;
 - leveraged trades;
 - trades in volatile or speculative funds; and
 - trades in accounts operating under limited trading authorizations.
3. The branch manager (or alternate) is responsible for following up on unusual trades identified by head office.
4. 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.

Daily Reviews

1. In addition to the trading review criteria for branch managers, head office must conduct daily reviews of account activity which should include 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;

- account number changes where the Member uses nominee name accounts.
- 2. There must be closer supervision of trading by registered salespersons who have had a history of questionable conduct.
- 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.

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.

MFDA POLICY NO. 3 ¹⁸

~~COMPLAINT HANDLING~~, SUPERVISORY INVESTIGATIONS AND INTERNAL DISCIPLINE

~~I. Complaints~~

~~1. Introduction~~

~~MFDA Rule 2.11 requires Members to establish and implement written policies and procedures for dealing with client complaints that ensure that such complaints are dealt with promptly and fairly. This Policy establishes minimum standards for the development and implementation of those procedures.~~

~~Compliance with the requirements of MFDA Rule 2.11 and this Policy must be supervised and monitored by the Member and its personnel in accordance with MFDA Rule 2.5.~~

~~2. Definition~~

~~A "complaint" shall be deemed to include any written or verbal statement of grievance, including electronic communications from a client, former client, or any person who is acting on behalf of a client and has written authorization to so act, or of a prospective client who has dealt with a Member or Approved Person, alleging a grievance involving the Member, Approved Person of the Member or former Approved Person of the Member, if the grievance involves matters that occurred while the Approved Person was an Approved Person of the Member.~~

~~3. Duty to Assess All Complaints~~

~~Members have a duty to engage in an adequate and reasonable assessment of all complaints.~~

~~All complaints are subject to the complaint handling requirements set out in Part I of this Policy. Certain complaints are subject to additional complaint handling requirements as set out in Part II of this Policy. Complaints must be assessed to determine whether, in the reasonable professional judgment of the Member's supervisory staff handling the complaint, they should be treated in accordance with the Additional Complaint Handling Requirements prescribed by Part II of this Policy.~~

~~All complaints, including complaints from non-clients in respect of their own affairs, in any way relating to the following must be dealt with in accordance with the Additional Complaint Handling Requirements prescribed by Part II of this Policy:~~

- ~~• a breach of client confidentiality;~~
- ~~• unsuitable investments or leveraging (except for non-clients);~~
- ~~• theft, fraud, misappropriation, forgery, misrepresentation, unauthorized trading;~~
- ~~• engaging in securities related business outside of the Member;~~

¹⁸ The MFDA Policy No. 3 is not consistent with sections 168.1.1 to 168.1.3 of the Securities Act with the exception of :

- Section 10 of Part I
- Part III
- Part IV
- Part V

- ~~engaging in an undeclared occupation outside the Member;~~
- ~~personal financial dealings with a client, money laundering, market manipulation or insider trading.~~

~~In determining whether any other complaints not relating to the matters set out above should be subject to the Additional Complaint Handling Requirements prescribed by Part II of this Policy supervisory staff should consider whether the complaint alleges a matter similar in nature or seriousness to those set out above, the complainant's expectation as to how the complaint should be handled and whether the complainant is alleging any financial harm. Where supervisory staff determines that a complaint does not meet any of these criteria the complaint must be handled fairly and promptly but can be concluded through an informal resolution.~~

~~4. Minimum Requirements for Complaints Subject to Informal Resolution~~

~~Any complaints that are subject to informal resolution must be handled fairly and responded to promptly (i.e. generally in less time than it would take for complaints subject to the Additional Complaint Handling Requirements prescribed by Part II of this Policy). Such complaints must also be resolved in accordance with internal Member complaint handling policies and procedures that clearly describe the process to be followed in the assessment and resolution of such matters. Certain complaints subject to informal resolution must also be reported under Policy No. 6.~~

~~Where a complaint subject to informal resolution is received in writing the Member must provide its substantive response in writing.~~

~~5. Member Assistance in Documenting Verbal Complaints~~

~~Members should be prepared to assist clients in documenting verbal complaints where it is apparent that such assistance is required.~~

~~6. Client Access~~

~~At the time of account opening, Members must provide to new clients a written summary of the Member's complaint handling procedures, which is clear and can easily be understood by clients. On account opening, the Member must also provide a Client Complaint Information Form ("CCIF"), as approved by MFDA staff, describing complaint escalation options, including complaining to the Ombudsman for Banking Services and Investments and complaining to the MFDA.~~

~~Members must ensure that information about their complaint handling process is made generally available to clients so that clients are informed as to how to file a complaint and to whom they should address a complaint. For example, Members who maintain a website must post their complaint handling procedures on their website.~~

~~Member procedures must provide a specific point of initial contact at head office for complaints or information about the Member's complaint handling process. This contact may be a designated person or may be a general inbox or telephone number that is continuously monitored. Members may also advise clients to address their complaints to the Approved Person servicing their account and to the Branch Manager supervising the Approved Person.~~

~~7. Fair Handling of Client Complaints~~

~~To achieve the objective of handling complaints fairly, Members' complaint handling procedures must include standards that allow for a factual investigation and an analysis of the matters specific to the complaint. Members must not have policies that allow for complaints to be~~

~~dismissed without due consideration of the facts of each case. There must be a balanced approach to the gathering of facts that objectively considers the interests of the complainant, the Approved Person and the Member.~~

~~The basis of the Member's analysis must be reasonable. For example, a suitability complaint must be considered in light of the same principles that would be applied by a reasonable Member in conducting a suitability review, which would include an acknowledgement of the complainant's stated risk tolerance. It would not be reasonable for a Member to assess suitability based on a risk level presumed by the Member that is higher than that indicated by the complainant. A further example of an unreasonable analysis is where a Member dismisses a complaint due to a simple uncorroborated denial by the Approved Person notwithstanding evidence in support of the complainant.~~

~~A Member's obligation to handle complaints in accordance with this Policy is not altered when a complainant engages legal counsel in the complaint process and where no litigation has commenced. Where litigation has been initiated by the complainant, the Member is expected to participate in the litigation process in a timely manner in accordance with the rules of procedure of the applicable jurisdiction and to refrain from acting in a way that is clearly unfair.~~

~~The Member's review of the complaint must result in the Member's substantive response to the complainant. Examples of an appropriate substantive response include a fair offer to resolve the complaint or a denial of the complaint with reasons. MFDA staff does not require that the complainant accept the Member's offer in order for the offer to be considered fair.~~

~~8. Prompt Handling of Client Complaints~~

~~The Member must handle the complaint and provide its substantive response within the time period expected of a Member acting diligently in the circumstances. The time period may vary depending on the complexity of the matter. The Member should determine its substantive response and notify the complainant in writing in most cases within three months of receipt of the complaint.~~

~~Further, staff recognizes that, if the complainant fails to co-operate during the complaint resolution process, or if the matter requires an extensive amount of fact-finding or complex legal analysis, time frames for the substantive response may need to be extended. In cases where a substantive response will not be provided within three months, the Member must advise the complainant as such, provide an explanation for the delay and also provide the Member's best estimate of the time required for the completion of the substantive response.~~

~~It is not required that the complainant accept the Member's substantive response. Where the Member has communicated its substantive response, the Member must continue to proactively address further communications from the complainant in a timely manner until no further action on the part of the Member is required.~~

~~9. General Complaint Handling Requirements~~

- ~~1. All client complaints and supervisory obligations must be handled by qualified sales supervisors/compliance staff. An individual who is the subject of a complaint must not handle the complaint unless the Member has no other supervisory staff who are qualified to handle such complaints.~~
- ~~2. Each Approved Person must report certain complaints and other information relevant to this Policy to the Member as required under MFDA Policy No. 6.~~
- ~~3. Each Member must put procedures in place so that senior management is made aware of complaints of serious misconduct and of all legal actions.~~

- ~~4. Members may use the electronic reporting system designated under MFDA Policy No. 6 (the "Member Event Tracking System" or "METS") as their complaint log for those complaints reported on METS. For complaints that are not required to be reported through METS Members must have policies and procedures for the detection of frequent and repetitive complaints made with respect to the same matter which may, on a cumulative basis, indicate a serious problem.~~
- ~~5. Follow-up documentation for all complaints must be kept in a central location along with the consolidated log of complaints. Alternatively, where a Member has various regional head offices or branches, the Member may keep follow-up documentation at any one regional head office or branch, so long as information about the handling of the complaint is in the Member head office log and the follow-up documentation can be produced in a timely manner.~~
- ~~6. Where the events relating to a complaint took place in part at another Member or a member of another SRO, Members and Approved Persons must cooperate with other Members or SRO members in the sharing of information necessary to address the complaint.~~

10. Settlement Agreements

No Approved Person shall, without the prior written consent of the Member, enter into any settlement agreement with, pay any compensation to or make any restitution to a client.

No Member or Approved Person of such Member may impose confidentiality restrictions on clients or a requirement to withdraw a complaint with respect to the MFDA or a securities commission, regulatory authority, law enforcement agency, SRO, stock exchange or other trading market as part of a resolution of a dispute or otherwise.

~~II. Additional Complaint Handling Requirements~~

~~Each Member's procedures for handling complaints that are subject to the requirements of this section must include the following:~~

- ~~1. **Initial Response**— An initial response letter must be sent to the complainant within a reasonable time, and generally within 5 business days of receipt of the complaint. If a complaint can be concluded in less than 5 business days then an initial response letter is not necessary. The initial response letter must include the following information:~~
 - ~~• A written acknowledgment of the complaint;~~
 - ~~• A request to the complainant for any additional reasonable information required to resolve the complaint;~~
 - ~~• The name, job title and full contact information of the individual at the Member handling the complaint;~~
 - ~~• A statement indicating that the complainant should contact the individual at the Member handling the complaint if he/she would like to inquire about the status of the complaint;~~
 - ~~• A summary of the Member's internal complaint handling process, including general timelines for providing the Member's response to complaints and a statement advising clients that each province and territory has a time limit for taking legal action; and~~

- ~~• A reference to an attached copy of the CCIF, and a reference to the fact that the CCIF contains information about applicable limitation periods.~~
- 2. ~~**Substantive Response**—The substantive response letter, which Members must provide to the complainant, may be accompanied by a summary of the Member's complaint handling procedures and must include a copy of the CCIF. The substantive response letter to complainants must also include the following information:~~
 - ~~• An outline of the complaint;~~
 - ~~• The Member's substantive decision on the complaint, including reasons for the decision; and~~
 - ~~• A reminder to the complainant that he/she has the right to consider: (i) presenting the complaint to the Ombudsman for Banking Services and Investments which will consider complaints brought to it within six months of the substantive response letter; (ii) making a complaint to the MFDA; (iii) litigation/civil action; or (iv) any other applicable options, such as an internal ombudservice provided by an affiliate of the Member.~~

III. Supervisory Investigations

A Member must monitor, through its supervisory personnel, all information that it receives regarding potential breaches of applicable requirements on the part of the Member and its current and former Approved Persons that raise the possibility of risk to the Member's clients or other investors. Applicable requirements include MFDA By-laws, Rules and Policies, other applicable legal and regulatory requirements and the Member's related internal policies and procedures. This applies to information received from both internal and external sources. For example, such information may come from client complaints, be identified during the Member's routine supervisory activity, or come from other Approved Persons of the Member or individuals outside the Member who are not clients.

For purposes of clarity, where the information is received by way of a client complaint, the supervisory duty goes beyond addressing the relief requested by the complainant and extends to a consideration of general risk at the Member. The duty to deal with the supervisory aspects of the matter continues when a complainant purports to withdraw the complaint or indicates satisfaction with the result of the Member's complaint handling.

Members must take reasonable supervisory action in relation to such information, the extent of which will in part depend on the severity of the allegation and the complexity of the issues. In all cases, the Member must track such information and note trends in risk, including those related to specific Approved Persons or branches, subject matter, product types, procedures and cases, and take necessary action in response to those trends as appropriate. In some cases, it will be necessary to conduct an active supervisory investigation in relation to the information received in specific situations and the level of the investigation must be reasonable in the circumstances.

For example, where the Member identifies unsuitable investment or leveraging recommendations by one of its Approved Persons, the investigation may extend to include determining relevant matters such as the understanding of the Approved Person and applicable supervisory personnel of the Member's policies and procedures and the possibility that such conduct occurred in relation to other clients.

With regard to the type of conduct outlined in Part I, Section 3 of this Policy, other than suitability, the Member has a duty to conduct a detailed investigation in all situations where there is information from any source, written or verbal, whether from an identified source or anonymous,

to raise the possibility that such conduct occurred. This duty applies to all conduct by the current or former Approved Person, whether it occurred inside or outside the Member.

The investigation must be sufficiently detailed and must include all reasonable steps to determine whether the potential activity occurred. Examples of the activities that the Member may need to take include:

- (a) interviewing or otherwise communicating with individuals such as:
 - the individuals of concern;
 - related supervisory personnel;
 - other branch staff;
 - head office personnel;
 - the client or other external individuals who brought the information to the Member's attention; or
 - other clients who may have been affected by the activity.
- (b) conducting a review at the branch or sub-branch.
- (c) reviewing documentation such as:
 - files of the Approved Person relating to Member business; or
 - files and other documents in the Approved Person's custody or control that relate to outside business, where there is a reasonable possibility that such information is relevant to the investigation. Members have the right to require such information to meet their supervisory responsibilities and Approved Persons have an obligation to cooperate with such requests.

IV. Internal Discipline

Each Member must establish procedures to ensure that breaches of MFDA By-laws, Rules and Policies are subjected to appropriate internal disciplinary measures.

V. Record Retention

Documentation associated with a Member's activity under this Policy shall be maintained for a minimum of 7 years from the creation of the record and made available to the MFDA upon request.

MFDA POLICY NO. 4 INTERNAL CONTROL POLICY STATEMENTS

MFDA INTERNAL CONTROL POLICY STATEMENT 1 - GENERAL MATTERS

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time."

"Internal control" is defined as follows:

"Internal control consists of the policies and procedures established and maintained by management to assist in achieving its objective of ensuring, as far as practical, the orderly and efficient conduct of the entity's business. The responsibility for ensuring adequate internal control is part of management's overall responsibility for the ongoing activities of the entity." (CICA Handbook, 5200.03)

The effectiveness of specific policies and procedures is affected by many factors, such as management philosophy and operating style, the function of the board of directors (or equivalent) and its committees, organizational structure, methods of assigning authority and responsibility, management control methods, system development methodology, personnel policies and practices, management reaction to external influences, and internal audit. These and other aspects of internal control affect all parts of the Member firm.

In addition to compliance with required policies and procedures set out in these Policy Statements, a Member must consider the following, to the extent that they suggest a higher standard than would otherwise be required:

- (i) Recommended provisions set out in these Policy Statements;
- (ii) Authoritative literature such as publications of the Mutual Fund Dealers Association of Canada, the MFDA Investor Protection Corporation, the Internal Control Guidelines published by the Investment Dealers Association of Canada and publications of the Canadian Institute of Chartered Accountants;
- (iii) Comments on internal control that may have been made by internal and external auditors and by industry regulators, and actions that the Member has taken as a result;
- (iv) Industry practice; and
- (v) The balance struck between preventive and detective controls. Preventive controls are those which prevent, or minimize the chance of occurrence of, fraud or error. Detective controls do not prevent fraud and error but rather detect them, or maximize the chance of their detection, so that corrective action may be promptly taken. The known existence of detective controls may have a deterrent effect and be preventive in that sense.

The extent of preventive controls implemented by a Member will depend on management's view of the risk of loss and the cost-benefit relationship of controlling such risk. Where the inherent risk is high (e.g. cash) the cost of effective preventive controls will usually be warranted and expected by industry regulators. On the other hand, where the inherent risk is very low (e.g. prepaid expenses), the cost of preventive controls would usually not be warranted nor expected by industry regulators. Further, in a circumstance where a preventive control is warranted, a detective control should not be considered to be a suitable alternative unless it will result in prompt detection of fraud and error and provide near certainty of recovery of the property that is the subject of the fraud or error.

For example, the safeguarding of clients' cash warrants the implementation of highly effective preventive controls. Accordingly, Members safeguard clients' cash by placing it in a trust account and performing monthly reconciliations.

Determining whether internal control is adequate is a matter of judgement. However, internal control is not adequate if it does not reduce to a relatively low level the risk of failing to meet control objectives stated in this series of Policy Statements and, as a consequence, one or more of the following conditions has occurred or could reasonably be expected to occur:

- (i) A Member is inhibited from promptly completing transactions or promptly discharging the Member's responsibilities to clients, to other members or to the industry;
- (ii) Material financial loss is suffered by the Member, clients or the industry;
- (iii) Material misstatements occur in the Member's financial statements; and
- (iv) Violations of the rules or standards occur to the extent that could reasonably be expected to result in the conditions described in (i) to (iii) above.

Other Policy Statements in this series set out control objectives, required and recommended firm policies and procedures and indications that internal control is not adequate. While recommended firm policies and procedures will be appropriate in many cases to meet the stated objectives, they constitute merely one of a number of methods which a Member may utilize. It is recognized that Members may conduct their business in compliance with legal and regulatory requirements although they may employ procedures which differ from the recommended firm policies and procedures contained in these Policy Statements. The information is designed to provide guidance to member firms in the preparation of procedures tailored to the specific needs of their individual environment in meeting the stated control objectives.

Members must maintain a detailed written record which as a minimum should include the specific policies and procedures approved by senior management to comply with these Policy Statements. These policies and procedures must be reviewed and approved in writing by senior management at least annually, or more frequently as the situation arises, for their adequacy and suitability. One method of documentation is to note on a copy of this Policy Statement the recommended policies and procedures which have been selected, and details of their performance such as who performs them, when, and how performance is evidenced. Other forms of documentation, such as procedures manuals, flow charts and narrative descriptions are recommended.

MFDA INTERNAL CONTROL POLICY STATEMENT 2 - CAPITAL ADEQUACY

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time." It should be read in the context of Internal Control Policy Statement 1 dealing with General Matters.

This Policy Statement focuses on the monitoring of a Member's capital position, principally through its system of management and financial reporting. The effectiveness of such monitoring depends in large measure on the timeliness, completeness and accuracy of the accounting books and records from which those management reports are drawn. Establishing and maintaining policies and procedures to ensure such timeliness, completeness and accuracy is part of a Member's responsibility for internal control. However, these matters are outside the scope of this Policy Statement 2.

Control Objective

To monitor and act upon information produced by the management reporting system so that Risk Adjusted Capital is maintained at all times in an amount at least equal to the minimum required by MFDA Rules.

Minimum Required Firm Policies and Procedures

1. A member of senior management (such as the Chief Financial Officer, Chief Operating Officer or Chief Executive Officer) is responsible for continuous monitoring of the capital position of the firm to ensure that at all times Risk Adjusted Capital is maintained as prescribed by the MFDA Rules.
2. The Member's planning process recognizes the projected capital requirements resulting from current and planned business activities.
3. At least monthly, or more frequently if required (e.g. when the Member is operating close to early warning levels), the member of senior management assigned the task for monitoring the capital position documents that he/she has:
 - (a) Received management reports produced by the accounting system showing information relevant to the calculated capital position;
 - (b) Obtained other information concerning items that, while they may not yet be recorded in the accounting system, are likely to significantly affect the capital position (e.g. bad and doubtful debts, unreconciled positions);
 - (c) Calculated the capital position, compared it to planned capital limits and the prior period and reported adverse trends or variances to senior management.
4. Senior management takes prompt action to avert or remedy any projected or actual capital deficiency and reports any deficiencies, when required, immediately to the appropriate regulators.
5. The month-end estimate of required risk adjusted capital is reconciled to the Monthly Financial Report submitted for regulatory filing. Material discrepancies are investigated and steps are taken to preclude re-occurrence.
6. At least annually, the member of senior management assigned the task for monitoring the capital position documents a supervisory review of the Member's management reporting system related to capital, to identify and implement changes required to reflect developments in the business or in the regulatory requirements.

Indications That Internal Control Is Not Adequate

- The accounting system produces information that is late or requires correction.
- Staff responsible for preparing risk adjusted capital reports lack an understanding of the regulatory requirements.
- The Chief Financial Officer or person designated with the supervisory tasks of monitoring the capital position of the firm lacks an understanding of the regulatory requirements.
- No steps are taken to establish the reliability of management reports utilized to monitor the capital position.
- Planning procedures fail to take into account the impact of planned activities on required capital.
- The Member is operating near its early warning levels.
- The Member experiences significant unexpected changes in its capital position.

MFDA INTERNAL CONTROL POLICY STATEMENT 3 - INSURANCE

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time." It should be read in the context of Internal Control Policy Statement 1 dealing with General Matters.

Control Objective

To ensure that:

- (a) The Member is in compliance with regulatory requirements for insurance;
- (b) Other insurance coverage is in accordance with business needs; and
- (c) Insurable losses are identified and claimed on a timely basis.

Minimum Firm Policies And Procedures

1. Insurance requirements and levels of coverage are reviewed and approved at least annually by the Member firm's Executive Committee or Board of Directors.
2. A senior officer of the firm is designated by the Member's Executive Committee or Board of Directors as responsible for insurance matters.
3. The senior officer or designated person assigned the task reviews the terms of the insurance policies regularly and ensures that the Member's operating procedures are designed to result in compliance with policy terms and regulations.
4. The senior officer or designated person assigned the task monitors business changes to evaluate the need for changes in coverage or operating procedures.
5. The senior officer or designated person assigned the task monitors business operations to ensure that insured losses are identified, the insurer is notified and losses are claimed on a timely basis and their effect on aggregate limits are taken into account.
6. Senior management takes prompt action to avert or remedy any projected or actual insurance deficiency and reports any deficiencies, when required, immediately to the appropriate regulators.

Indications That Internal Control Is Not Adequate

- Staff responsible for insurance matters are ill-informed of their duties or insufficiently trained.
- Material breaches of insurance policies which could result in denial of coverage are not detected on a timely basis.
- No steps are taken to establish the reliability of reports utilized for the monitoring of variables that may affect insurance coverage.
- Failure to report claims or to recover claims thought to be covered.
- Deficiencies in coverage are indicated on regulatory capital filings.

MFDA INTERNAL CONTROL POLICY STATEMENT 4 - CASH AND SECURITIES

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time." It should be read in the context of Internal Control Policy Statement 1 dealing with General Matters.

Control Objective

To safeguard both firm and clients securities and cash so that:

- (a) Securities and cash are protected against material loss; and
- (b) Potential losses are detected and reported (for regulatory and insurance purposes) on a timely basis.

Minimum Required Firm Policies And Procedures

Trading-General

1. Trade confirmations or confirmation reports containing evidence of settlement activity ("confirmation records") are reconciled with the Member's trading blotters at least weekly.
2. The reconciliation should be performed by personnel who do not have the ability to enter transactional data.
3. Discrepancies between the Member's trading blotters and confirmation records must be investigated and resolved immediately.

Trading-Nominee Name Accounts

1. The Member has a proper written agreement with each acceptable securities location used to hold securities.
2. At least monthly, the information system produces a report (e.g. client positions) of securities owned by clients but registered in the name of or held by the Member that require segregation and a reconciliation with third party information (e.g. monthly statements from the fund company) is performed to identify deficiencies.
3. Where a deficiency exists, the Member of senior management designated the task of monitoring the capital position of the firm should be advised of the deficiency in order to determine if it impacts the Member's capital position.
4. There is supervisory review or other procedures in place to ensure the completeness and accuracy of the report of client holdings produced by the Member's information system.
5. Journal entries made to the Member or clients' securities holdings are properly reviewed and approved before processing.
6. The Member has a system in place to record and allocate the total amounts of dividends and interest payable and receivable at the due date.
7. Non-resident tax is withheld where applicable by law.
8. A system is in place to ensure appropriate reporting of client income for tax purposes, as required by law.

Cash-General

1. A senior official is responsible for reviewing and approving all bank reconciliations.
2. Bank accounts (including trust accounts) are reconciled, in writing, at least monthly with identification and dating of all reconciling items.
3. Journal entries to clear reconciling items are made on a timely basis and approved by management.
4. The reconciliation of bank accounts (including trust accounts), where practical, is not performed by someone with incompatible functions, including access to funds (both receipts and disbursements), access to record keeping responsibilities, including the authority to write or approve journal entries. At a minimum, the individual responsible for the reconciliation should be independent from the individual having access to funds.
5. Approval levels required to requisition a cheque are established by senior management.
6. Cheques are pre-numbered and numerical continuity is accounted for.
7. Blank cheques are properly safeguarded.
8. Cheques are signed by two authorized individuals.
9. Cheques are only signed when the appropriate supporting documentation is provided. The supporting documentation is cancelled after the cheque is signed.
10. Where facsimile signature is used, access to the machine is limited and supervised.
11. A limited number of authorized personnel are permitted to withdraw monies from bank accounts, including by way of electronic transfer.

Trust Accounts For Client Funds

1. All client cheques are recorded upon receipt by the Member and deposited to the trust account on the day of receipt. If a cheque is received after normal business hours, the cheque is deposited the following business day.
2. Deposits to the trust account are balanced daily against deposit records, receivable records, and mutual fund settlement records.
3. Trust accounts are established to bear interest at rates equivalent to comparable accounts of the financial institution.
4. Money received from clients for investment in mutual funds is not used to finance the Member's operations. This would include offsetting bank charges with interest earned on monies held in trust.
5. The Member distributes interest earned on the mutual fund trust account on a cash basis to either the mutual fund companies or mutual fund investors.

Indication That Internal Controls Are Inadequate

- There is a significant number and dollar value of unreconciled positions and balances.
- Significant differences in reconciliations are not resolved on a timely basis.

- A large number of staff is involved in reconciling positions.
- Material losses have occurred.

MFDA INTERNAL CONTROL POLICY STATEMENT 5 - SEGREGATION OF CLIENTS' SECURITIES

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time." It should be read in the context of Internal Control Policy Statement 1 dealing with General Matters.

This Policy Statement is applicable where client securities are held by or in the name of the Member for the benefit of the client.

Control Objective

To segregate clients' securities so that:

- (a) The Member is in compliance with regulatory and legal requirements for segregation; and
- (b) Securities are not improperly used.

Minimum Required Firm Policies And Procedures

1. Securities requiring segregation are placed in "acceptable securities locations", as defined by MFDA Rules, on a timely basis.
2. Written custodial agreements with applicable regulatory provisions exist for securities held at acceptable securities locations.
3. Securities are moved into or out of segregation only by authorized personnel.
4. A client is identified for each transaction.
5. At least monthly, the information system produces a report (e.g. client positions) of securities owned by clients but registered in the name of or held by the Member that require segregation and a reconciliation with third party information (e.g. monthly statements from the fund company) is performed to identify deficiencies.
6. Where a deficiency exists, the member of senior management assigned the task of monitoring the capital position of the firm should be advised of the deficiency in order to determine if it impacts the firm's capital position.
7. There is a monthly supervisory review of compliance with segregation requirements for clients' securities.

Indication That Internal Controls Are Inadequate

- Insufficient attention is paid to preventing violations of legal and regulatory provisions concerning securities held in segregation, including preventing the hypothecation of securities.
- Securities are held without a written custodial agreement.

MFDA POLICY NO. 5

BRANCH REVIEW REQUIREMENTS

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 in the course of conducting compliance examinations and may impose additional requirements to ensure compliance with MFDA By-laws, Rules and Policies.

Branch Review Procedures

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

a) General Requirements

- The Branch Review 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 address all significant aspects of the Member’s policies and procedures manual and MFDA By-laws, Rules and Policies.
- The Branch Review Program 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 requirements under MFDA By-laws, Rules and Policies and applicable securities regulation. 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 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 Sales Communications, Advertising and Client Communications

- The Branch Review Program must include a review of sales communications, advertising and client communications, including 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;
 - 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 must provide for the review of files of Approved Persons relating to non-Member business.

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;
- complaint 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
- the date of the last review.

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 locations as high, medium or low risk using appropriate criteria. Such criteria would include the factors set out above under “Scope of Review”. 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 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 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 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 to ensure that the issues identified in the course of the branch review are followed up and resolved. Therefore, the Branch Review Program 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.

~~INFORMATION REPORTING REQUIREMENTS~~

~~1. Introduction~~

~~This Policy establishes minimum requirements concerning events that Approved Persons are required to report to Members and events that Members are required to report to the MFDA pursuant to Rule 1.2.5.~~

~~Part A of this Policy, entitled “Approved Person Reporting Requirements”, sets out details regarding the reporting of information under Rule 1.2.5(b) by Approved Persons.~~

~~Part B of this Policy, entitled “Electronic Reporting Requirements for Members”, sets out details regarding reporting of information under Rule 1.2.5(a)(i) and Rule 1.2.5(a)(ii) by Members. All reporting under Part B must be submitted through the electronic reporting system provided by the MFDA. The reporting of events that are required to be submitted electronically by any other means is a failure to report the event and a failure to comply with this Policy.~~

~~Part C of this Policy, entitled “Other Reporting Requirements for Members”, sets out details regarding reporting of information under Rule 1.2.5(a)(iii) by Members. All reporting under Part C must be submitted to the MFDA in writing.~~

~~In addition to these reporting requirements, MFDA Members are required to comply with other reporting requirements which may change from time to time, and which include but are not limited to:~~

~~(a) MFDA reporting requirements, some of which may also require MFDA approval:~~

- ~~(i) By-law No.1 section 13.7—Reorganizations, mergers and amalgamations;~~
- ~~(ii) By-law No. 1 section 13.9—Changes in ownership and control;~~
- ~~(iii) Rule 1.1.6—Introducing/Carrying dealer arrangements;~~
- ~~(iv) Rule 3.1.1—Change in dealer level;~~
- ~~(v) Rule 3.1.2—Risk adjusted capital less than zero;~~
- ~~(vi) Rule 3.2.5—Accelerated payment of long term debt; and~~
- ~~(vii) Rule 3.5—Financial filing requirements~~

~~(b) reporting requirements under applicable provincial securities laws in connection with a Member’s mutual fund dealer registration.~~

~~2. Definitions~~

~~“any jurisdiction” means any jurisdiction inside or outside of Canada.~~

~~“business day” means a day other than Saturday, Sunday or any officially recognized Federal or Provincial Statutory holiday.~~

~~“civil claim” includes civil claims pending before a court or tribunal and arbitration.~~

~~“client” means a person who is a client of the Member.~~

¹⁹ Policy No. 6 is not consistent with the reporting requirements of the Securities Act, Securities Regulation, Regulation 31-103 and Regulation 33-109.

“compensation” means the payment of a sum of money, securities, reversal or inclusion of a securities transaction (whether the transaction has a realized or unrealized loss) or any other equivalent type of entry which is intended to compensate a client or offset an act of a Member or Approved Person. A correction of a client account or position as a result of good faith trading errors and omissions is not considered to be “compensation” for the purposes of this Policy.

“event” means a matter that is reportable under this Policy by a Member or Approved Person.

“law” includes, but is not limited to, all legislation of any jurisdiction and includes any rules, policies, regulations, rulings or directives of any securities regulatory authority of any jurisdiction.

“member business” means all business activities conducted by and through the Member, whether securities related or otherwise.

“misrepresentation” means:

(i) — an untrue statement of fact, either in whole or in part; or

(ii) — an omission to state a fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

“regulatory body” means, but is not limited to, any regulatory or self-regulatory organization that grants persons or organizations the right to deal with the public in any capacity.

“regulatory requirements” means, but is not limited to, the by-laws, rules, policies, regulations, rulings, orders, terms and conditions of registration, or agreements of any regulatory body in any jurisdiction.

“securities” includes exchange contracts, commodity futures contracts and commodity futures options.

“service complaints” means:

(i) — any complaint by a client which is founded on customer service issues and is not the subject of any securities law or regulatory requirements; or

(ii) — any complaint by a client as a result of a good faith trading error or omission.

3. — General Reporting Requirements

3.1. — Events regarding Members that must be reported shall not be limited solely to securities related business, but shall include all member business.

3.2. — Events regarding Approved Persons that are reported by Approved Persons to the Member shall not be limited solely to securities related business and member business, but shall include all business conducted by the Approved Person.

3.3. — The obligation to report an event under this Policy is limited to events of which a Member or Approved Person has become aware regardless of the means by which the Member or Approved Person became aware of the event. If the reporting timeframes have expired before the Member or Approved Person has become aware of the event, the event shall be reported immediately after the Member or Approved Person has become aware of such event.

3.4. — A Member is expected to be aware of events relating to Approved Persons by the receipt of reports from Approved Persons and by carrying out the Member's supervisory, monitoring and review obligations over the conduct of its business.

- ~~3.5.— All requirements to report events regarding former Approved Persons are limited to events which occurred while the Approved Person was an Approved Person of the Member.~~
- ~~3.6.— A Member shall designate a compliance officer at its head office (or another person at head office) to whom reports made by Approved Persons, as required by section 4, shall be submitted.~~
- ~~3.7.— Documentation associated with each event required to be reported under this Policy shall be maintained for a minimum of 7 years from the resolution of the matter and made available to the MFDA upon request.~~

~~PART A~~
~~APPROVED PERSON REPORTING REQUIREMENTS~~

~~4.— Approved Person Reporting Requirements~~

- ~~4.1.— An Approved Person shall report the following events to his or her current Member in such detail as required by the Member, within 2 business days:~~
- ~~(a) — the Approved Person is the subject of a client complaint in writing;~~
 - ~~(b) — the Approved Person is aware of a complaint from any person, whether in writing or any other form, and with respect to him or herself, or any other Approved Person, involving allegations of:
 - ~~(i) — theft, fraud, misappropriation, forgery, money laundering, market manipulation, insider trading, misrepresentation, or unauthorized trading;~~
 - ~~(ii) — a breach of client confidentiality;~~
 - ~~(iii) — engaging in securities related business outside of the Member;~~
 - ~~(iv) — engaging in an undeclared occupation outside the Member; or~~
 - ~~(v) — personal financial dealings with a client.~~~~
 - ~~(c) — whenever the Approved Person has reason to believe that he or she has or may have contravened, or is named as a defendant or respondent in any proceeding, in any jurisdiction, alleging the contravention of:
 - ~~(i) — any securities law; or~~
 - ~~(ii) — any regulatory requirements.~~~~
 - ~~(d) — the Approved Person is charged with, convicted of, pleads guilty or no contest to, any criminal offence, in any jurisdiction;~~
 - ~~(e) — the Approved Person is named as a defendant in a civil claim, in any jurisdiction, relating to the handling of client accounts or trading or advising in securities;~~
 - ~~(f) — the Approved Person is denied registration or a license that allows the Approved Person to deal with the public in any capacity by any regulatory body, or has such registration or license cancelled, suspended or terminated, or made subject to terms and conditions;~~

- ~~(g) — the Approved Person becomes bankrupt or suspends payment of debts generally or makes an arrangement with creditors or makes an assignment or is deemed insolvent;~~
- ~~(h) — there are garnishments outstanding or rendered against the Approved Person.~~

PART B

ELECTRONIC REPORTING REQUIREMENTS FOR MEMBERS

5. — General Member Electronic Reporting Requirements

~~5.1. — Members shall report the following events to the MFDA, through an electronic reporting system provided by the MFDA, within 5 business days of the occurrence of the event, except for events reported under section 6.1(a) of this Policy, which must be reported to the MFDA within 20 business days.~~

6. — General Events to be Reported

~~6.1. — Members shall report to the MFDA:~~

- ~~(a) — all client complaints in writing, against the Member or a current or former Approved Person, relating to member business, except service complaints;~~
- ~~(b) — whenever a Member is aware, through a written or verbal complaint or otherwise, that the Member or any current or former Approved Person has or may have contravened any law or regulatory requirement, relating to:
 - ~~(i) — theft, fraud, misappropriation, forgery, money laundering, market manipulation, insider trading, misrepresentation, or unauthorized trading;~~
 - ~~(ii) — a breach of client confidentiality;~~
 - ~~(iii) — engaging in securities related business outside of the Member;~~
 - ~~(iv) — engaging in an undeclared occupation outside the Member; or~~
 - ~~(v) — personal financial dealings with a client.~~~~
- ~~(c) — whenever the Member, or a current or former Approved Person, is:
 - ~~(i) — charged with, convicted of, pleads guilty or no contest to, any criminal offence, in any jurisdiction;~~
 - ~~(ii) — named as a defendant or respondent in, or is subject of, any proceeding or disciplinary action, in any jurisdiction, alleging contravention of any securities law;~~
 - ~~(iii) — named as a defendant or respondent in, or is the subject of, any proceeding or disciplinary action, in any jurisdiction, alleging contravention of regulatory requirements;~~
 - ~~(iv) — denied registration or a license that allows a person to deal with the public in any capacity by any regulatory body, or has such registration or license cancelled, suspended or terminated, or made subject to terms and conditions;~~~~

~~(v) named as a defendant in a civil claim, in any jurisdiction, relating to handling of client accounts or trading or advising in securities.~~

~~(d) whenever an Approved Person becomes bankrupt or suspends payment of debts generally or makes an arrangement with creditors or makes an assignment or is deemed insolvent;~~

~~(e) there are garnishments outstanding or rendered against the Member or an Approved Person.~~

~~7. Reporting of Updates and Resolution of Events~~

~~7.1. Members shall update event reports previously reported to reflect updates to, or the resolution of, any event that has been reported pursuant to section 6.1 of this Policy within 5 business days of the occurrence of the update or resolution and such update or resolution shall include but not be limited to:~~

~~(a) any judgments, awards, arbitration awards or orders and settlements in any jurisdiction;~~

~~(b) compensation paid to clients directly or indirectly, or any benefit received by clients from a Member or Approved Person directly or indirectly;~~

~~(c) any internal disciplinary action or sanction against an Approved Person by a Member;~~

~~(d) the termination of an Approved Person;~~

~~(e) the results of any internal investigation conducted.~~

~~8. Other Events to be Reported~~

~~8.1. For matters that are not the subject of an event report in section 6.1 of this Policy, the Member shall report to the MFDA:~~

~~(a) whenever the Member has initiated disciplinary action that involves suspension, demotion or the imposition of increased supervision on an Approved Person;~~

~~(b) whenever the Member has initiated disciplinary action that involves the withholding of commissions or the imposition of a financial penalty in excess of \$1000;~~

~~(c) whenever an employment or agency relationship with an Approved Person is terminated and the Notice of Termination filed with the applicable securities commission discloses that the Approved Person was terminated for cause, or discloses information regarding internal discipline matters or restrictions for violations of regulatory requirements;~~

~~(d) whenever the Member or Approved Person has paid compensation to a client either directly or indirectly in an amount exceeding \$15,000.~~

PART C
OTHER REPORTING REQUIREMENTS FOR MEMBERS

9. — Other Information Reporting Requirements for Member

9.1. — Members shall report the events under Part C of this Policy to the MFDA, in writing, within 5 business days of the occurrence of the event, except for events reported under section 10 of this Policy, which must be reported to the MFDA immediately.

10. — Bankruptcy, Insolvency and Related Events

10.1. — Members must report to the MFDA whenever:

- (a) — the Member is declared bankrupt;
- (b) — the Member makes a voluntary assignment in bankruptcy;
- (c) — the Member makes a proposal under any legislation relating to bankruptcy or insolvency;
- (d) — the Member is subject to, or instituting any proceedings, arrangement or compromise with creditors;
- (e) — a receiver and/or manager assumes control of the Member's assets.

11. — Change of Name

11.1. — Members must report to the MFDA any change with respect to:

- (a) — the legal name of the Member;
- (b) — the names under which the Member carries on business (trade or style names);
- (c) — trade, business or style names, other than that of the Member, used by Approved Persons. The name of the Approved Person, the trade or business name the Approved Person is using, and the Approved Person's branch location must be provided.

12. — Change of Contact Information

12.1. — Members must notify the MFDA of any change in address for service or main telephone or fax number.

13. — Change in Member Registration or Licensing

13.1. — Members must report to the MFDA any changes in the following:

- (a) — type of registration or licensing with the relevant securities commission;
- (b) — jurisdictions in which any dealer business of the Member is conducted; and
- (c) — investment products traded or dealt in.

14. — Changes in Organizational Structure

~~14.1. Members must report to the MFDA any changes in a Member's directors, partners (in the case of a partnership), officers and compliance officers.~~

~~**15. Other Business Activities**~~

~~15.1. Members must report to the MFDA any business, other than the sale of investment products, which the Member engages in or proposes to engage in.~~

~~**16. Change of Auditor**~~

~~16.1. Members must report to the MFDA any change in a Member's auditor and/or audit engagement partner. A new Letter of Acknowledgement (Schedule H.1 of the MFDA Membership Application Package) must be submitted to the MFDA.~~