

NOTICE OF THE BUREAU

Limited Powers of Attorney and Letters of Authorization used by Group Savings Brokerage Firms within the Scope of Transactions Concerning Mutual Fund Securities

Introduction

The Bureau des services financiers wishes to support the notice of the staff of the Commission des valeurs mobilières du Québec and of most of the staff of the Canadian Securities Administrators (CSA) concerning the use of powers of attorney, letters of authorization or authorizations of operations (collectively, “powers of attorney”) within the scope of the subscription and the redemption of mutual funds securities by group savings brokerage firms and their representatives.

Context

Canadian Standard 81-102 prohibits a mutual fund from paying the product of a redemption before it has received a written redemption application from the holder of the securities. However, it is not necessary to obtain such written application when the mutual fund and the holder of the securities make “arrangements”. The mutual fund industry generally accepted, as acceptable “arrangements” the powers of attorney given by a client to his broker (now group savings brokerage firm) to authorize it to subscribe and to redeem securities in his name.

Mutual funds securities are often registered in the name of the client. Mutual funds must obtain from the registered shareholder (i.e. the investor), instructions as to the execution of an operation. Therefore, when a firm gives an order on behalf of his client, the mutual fund must ask the firm to send him the instructions signed by the client for each operation before processing the operation in the name of the client. At the same time, the Bureau is aware of the difficulties which the obligation to obtain the signature of a client for each operation represents for a firm. As for the staff of the Commission, the Bureau assumes that several mutual funds will accept a power of attorney signed by the client as an authorization of his firm to request an operation in the name of the client.

Concerns

The Bureau is very concerned about the scope and the form of the powers of attorney given by a client to his firm and to his firm’s representative. Verifications of compliance which were done both as regard the activities of firms as those of fund managers corroborated those concerns, by revealing that many powers of attorney impart to firms and their representatives unlimited powers that are not permitted for their registration or certification. Such unlimited powers of attorney may authorize a firm’s representatives to pass on orders for which the client has not given prior specific instructions. This problem of discretionary power is even more acute when the firm exercises little supervision, even no supervision at all, over its representatives. When a firm does not closely supervise the use of powers of attorney, there are much greater risks that the improper use of powers of attorney will not be prevented or detected.

In addition, it must be noted that, further to inspections, corrective measures have been implemented by firms that use unlimited powers of attorney.

The Bureau shares the fears of the CSA with regard to the manner in which these powers of attorney are submitted to clients and wonders whether clients understand the contents of the documents as well as the risks inherent to the use of unlimited powers of attorney.

Recommendations

Mutual funds and their representatives should stop using powers of attorney that confer upon them unlimited and discretionary powers over their clients' accounts.

In order to ensure adequate use of powers of attorney, the Bureau recommends that the firms prepare a standard document or power of attorney form that:

- clearly indicates the name of the firm as well as the name of the representative involved;
- provides a space for the signature of an executive, partner, director or branch manager designated by the firm as an attestation that the designated signatory approves and accepts the power of attorney;
- provides a space for the signature of the firm's representative;
- specifies that the power of attorney will terminate, where applicable, as soon as the representative in question leaves his employment with the firm;
- clearly establishes that the power of attorney applies only to the operations having to do with mutual funds securities and that the firm's representative must obtain the client's specific consent before performing each operation;
- clearly establishes that the firm's representative is only authorized to make investment recommendations and to carry out the client's orders, and that he is not entitled to make any decision whatsoever concerning the purchase or the sale of mutual fund securities on behalf of clients;
- bears a title that clearly brings out the limits of the scope and of the powers given by the client to the firm and his representative. Acceptable titles include "Limited Power of Attorney" and "Letter of Authorization";
- specifies that the client may cancel the power of attorney at any time.

Firms must have the document examined by a legal adviser in order to make sure that this document does not impart discretionary powers on a client's account to firms or their representatives.

The Bureau also recommends that the firms set up control processes on the use of powers of attorney. These processes must be in writing and include the following controls:

- A copy of the operation authorization must be enclosed with each operation order form in order to make sure that the branch manager, the head office and the mutual funds have proof of the authorization. The operation order form must indicate whether the firm's file contains a power of attorney. The firm must also make sure that a copy of the power of attorney is added to the file of the firm's representative.

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- Firms must apply adequate verification processes of the client's signature.
- Firms must set up registration and preservation procedures, on electronic or manual support, of the verbal or written instructions given by the clients for the carrying out of the operations.
- Firms must set up a method for identifying the accounts of the clients who gave a limited power of attorney.
- Branch managers and the head office must exercise a more vigilant supervision of these accounts, either regularly before an operation is carried out or within a reasonable time period after an operation is carried out, to make sure that all the operations are done in accordance with the specific instructions received previously from the client and that they are in keeping with the client's objectives.
- Procedures must be set up in order to make sure that clients receive a confirmation for each operation, directly from the mutual fund, or the firm's head office.

Before they can use the limited power of attorney, the Bureau also asks that mutual funds submit a copy of their internal control procedures, as well as a copy of the power of attorney, unless these documents have already been submitted to the Commission des valeurs mobilières when they were registered with that agency.

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