

13.1.7 OSC Staff Notice of Approval – MFDA amendments to MFDA Rule 3.3.2 and Internal Control Policy Statement 4

**OSC STAFF NOTICE OF COMMISSION APPROVAL**

**MUTUAL FUNDS DEALERS ASSOCIATION OF CANADA**

**MFDA AMENDMENTS TO MFDA RULE 3.3.2 (SEGREGATION OF CLIENT PROPERTY – CASH) AND INTERNAL CONTROL POLICY STATEMENT 4 (CASH AND SECURITIES) CONTAINED IN POLICY NO. 4**

The Ontario Securities Commission approved the MFDA's amendments to MFDA Rule 3.3.2 (Segregation of Client Property – Cash) and Internal Control Policy Statement 4 (Cash and Securities) contained in Policy No. 4; subject to the condition that the MFDA must not implement the amendments to Rule 3.3.2 and Policy No. 4 until the amendments to NI 81-102 Mutual Funds (NI 81-102) are in force.

The Alberta Securities Commission, Saskatchewan Financial Services Commission, Manitoba Securities Commission, Nova Scotia Securities Commission and New Brunswick Securities Commission have approved the amendments, and the British Columbia Securities Commission did not object to the MFDA's amendment.

**Summary of Material Rule**

The amendments remove the existing requirements to hold client cash for investment in mutual funds separately from client cash for other investments. These funds may now be commingled with other client assets, but must still be segregated from dealer property through the use of a trust account.

In addition, the amendments would allow for the MFDA member to disclose whether interest will be paid on client cash held in trust and, if so, at what rate. Any changes to the interest rate may only be made on at least 60 days written notice to the client. Interest received that is owed to clients must also be segregated as client property.

**Summary of Public Comments**

The OSC published the amendments for comment on June 25, 2010 at (2010) 33 OSCB 5963 for a 91-day comment period. The MFDA received three public comment letters. We attach the MFDA's summary of public comments received and responses as Attachment A.

## Attachment A

### Summary of Public Comments Respecting Proposed Amendments to MFDA Rule 3.3.2 (Segregation of Client Property) and Responses of the MFDA

On June 25, 2010, the British Columbia Securities Commission and Ontario Securities Commission published proposed amendments to MFDA Rule 3.3.2 (Segregation of Client Property) (the "Proposed Amendments") for a 90-day public comment period.

The public comment period expired on September 24, 2010.

3 submissions were received during the public comment period:

1. BMO Investments Inc. ("BMOII")
2. IGM Financial Inc. ("IGM")
3. Manulife Securities Investment Services Inc. ("Manulife")

Copies of comment submissions may be viewed at the offices of the MFDA, 121 King Street West, Suite 1000, Toronto, Ontario by contacting Ken Woodard, Director, Communications and Membership Services, (416) 943-4602.

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

#### Support for Amendments

All the commenters expressed support for the Proposed Amendments, noting that they will provide clarity and transparency for investors, promote greater efficiency in the administration of trust accounts by MFDA Members, hence reducing Member costs, and help create harmonization within the industry by creating similar rules to those that are in place for members of the Investment Industry Regulatory Organization of Canada ("IIROC").

#### MFDA Response

We acknowledge the support for the Proposed Amendments.

#### Requirement to Provide 60 Days Notice of Changes in Interest Rate

IGM expressed the view that the requirement to provide 60 days' prior notice to the client of any changes to the interest rate is impractical, noting that, in practice, all such deposits with any financial institution will be deposited to an account with a floating rate of interest as opposed to a fixed rate instrument such as a term deposit. IGM noted that because the interest paid by financial institutions on these accounts changes frequently, it is impractical to advise the client of the actual interest rate at the time of account opening, or with any notice of changes in the future. IGM suggested that it should be sufficient if, at the time of account opening, the client receives information as to whether or not interest will be paid on the account and is advised that current information regarding the rate, or how it is set, will be available on the Member's website or by other means. IGM noted that this is consistent with how IIROC members and banks provide their clients with information regarding interest paid or charged on their accounts.

#### MFDA Response

Members may satisfy the requirement of proposed Rule 3.3.2(e) by disclosing to the client, on account opening, the fact that the interest rate paid is a variable rate (e.g. prime plus 1%). If the interest rate is variable, the requirement with respect to written notification of subsequent changes to the rate would not apply, unless there is a change in the basis upon which the rate is calculated. MFDA staff will provide this clarification in a companion Member Regulation Notice.

#### Use of Client Free Credit Balances

BMOII noted that it is in favour of revisiting with the MFDA, in concept, a discussion regarding Members' ability to use free credit balances, suggesting that this would include consideration of clear, plain language and periodic disclosure to clients, internal and regulatory controls and supervision that could be implemented to ensure investor protection (having regard to the IIROC regime and experience) and capital requirements that would be appropriate in the circumstances. BMOII commented that opportunities to further create a level playing field among members of self-regulatory organizations can and should be explored in order to ensure that competitiveness among dealers is based on product and service rather than regulatory differentiation.

**MFDA Response**

Amendments to allow Members to use client free credit balances would have a number of impacts requiring careful study. In addition to the considerations noted by the commenter, MFDA staff would need to consider whether allowing Members to use free credit balances would result in a benefit to the membership commensurate with the added cost of regulating two different systems (i.e. Members using free credit balances and those who are not). When sufficient regulatory resources are available having regard to the number of Rules that would be impacted, and other issues that would need to be considered, MFDA staff will bring this matter forward for discussion.