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September 11, 2008

Mr. Gregory J. Ljubic
Corporate Secretary
Mutual Fund Dealers Association of Canada
121 King Street West Suite 1000
Toronto, ON M5H 3T9

Dear Mr. Ljubic:

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

Advocis appreciates the opportunity to comment on the Proposed Amendments to MFDA Rule 2.2 (Client Accounts) and MFDA Policy No 2 *Minimum Standards for Account Supervision*.

Advocis is a national professional association that is committed to preparing, promoting and protecting financial advisors in the public interest. We do this by providing a professional platform including career support, designations, best practices direction, education, timely information and professional liability insurance. This strengthens the relationship of trust and respect between financial advisors and their clients, the public, and government. Advocis is Canada's largest association of financial advisors, representing life and health insurance licensees, and mutual fund and securities registrants across the country for over a century. Our members are individuals, the majority of whom carry on business as either sole proprietors or independent, small businesses. A smaller proportion of Advocis members operate under employee-employer arrangements of financial services firms. We represent advisors at all stages of the business cycle, ranging from new entrants to the industry through to mature practices led by leaders in the industry serving a significant client base.

Overview

The MFDA states that current Rule 2.2 addresses the basic business conduct and client record requirements that Members must satisfy with respect to client accounts maintained by the Members. The current Rule prescribes: the requirement to collect know-your-client ("KYC") information when an account is opened; the requirement to ensure that recommendations made for the client's account are suitable; the requirement to complete a new account application form for each account; the requirement that each account be approved by a designated individual; and the requirement to document material updates to KYC information. The Proposed Amendments are intended to clarify the duty of Members and Approved Persons to assess the suitability of investments in each client account when various triggering events occur. It also requires that investors be provided with certain fundamental information at the time that an account is opened. The Proposed Amendments would effectively set a new minimum standard of relationship disclosure for clients of all Members.

MFDA Policy No. 2 establishes minimum industry standards for supervision of client accounts and expands upon the basic requirements contained in Rule 2.2. Policy No. 2 provides guidance with respect to account opening documentation to be maintained and supervisory procedures to be completed at the branch and head office levels. The amendments to Policy No. 2 are intended to clarify the responsibilities of members and Approved Persons in discharging their suitability obligations.

The Proposed Amendments to the Rule and Policy have been drafted with an outcomes-based focus to some degree, which is encouraging. However, concerns remain with respect to the policy process adopted by the MFDA which excludes some stakeholders from the early policy formulation process, thus narrowing the discussion of regulatory options available to address issues and concerns, and results in provisions which fail to recognize the business realities for many affected stakeholders.

General Comments

Proposed Amendments to Policy No. 2 provides guidance with respect to account opening documentation to be maintained and supervisory procedures to be completed at the branch and head office levels. The amendments are drafted with attention to achieving outcomes, and this is encouraging. While changes may appear reasonable, given that they are guidance, they must be viewed through the possible consequences of Proposed Amendments to MFDA By-Law No. 1, sec 25.4 coming into force (Please see our July 15, 2008 submission on this matter). In our view, the Proposed Amendment to MFDA By-Law No. 1, sec. 25.4 has the effect of making guidelines, bulletins, policies and other instruments binding on participants and is tantamount to rule-making. If the Proposed Amendments to By-law No. 1 come into force then policies, notices and guidelines will have all the force of a rule, but will not be subject to Member approval. Accordingly, the MFDA characterization of these amendments as **guidelines** may be misleading.

We note that the Proposed Amendments to Policy No 2 are consistent with Notice MR-0069 *Suitability Guidelines* (the, Notice). We question the need to replace a notice with a policy at this time. The Notice was issued on April 14, 2008. If the Notice was viewed as acceptable in April we believe that sufficient time should be allotted to first determine if the Notice will achieve the MFDA's desired outcome before resorting to any other regulatory tool. As the Notice has only been in existence for a few months, it seems counterintuitive to move prematurely and amend Policy No.2. From a regulatory development perspective, the MFDA will not be able to determine if a change in Member and/or Approved Persons actions are the result of the Notice, the Proposed Amendments to Policy No. 2 or Rule 2.2. If the Notice proved to be ineffective, prior to moving to amend existing rules and policies, it would be reasonable for the regulator to first determine why the notice failed to achieve the desired outcome prior to moving to other potentially more invasive regulatory tools.

Advocis believes that the Proposed Amendments to MFDA Rule 2.2 are drafted with attention to outcomes and is generally in line with developments within the Canadian Securities Administrators (CSA). For example Rule 2.2.4, *Updating Client Information,* provides a definition for "material change in client information". We feel this is a prime example of when prescriptive drafting is helpful in achieving a particular outcome. Similarly, Rule 2.2.5, *Relationship Disclosure,* requires that for each new account opened, the Member must provide written disclosure to the client. The requirements of what is expected in the written disclosure are then

listed in (a) through (g) and are principles-based. This approach allows Members to determine the final product themselves, while ensuring that the client is provided useful information.

Despite the positive elements in the outcomes-based drafting there remain issues that result from inadequate early participation in the policy process by MFDA non-Members. Again referring to Rule 2.2.5, we note that the MFDA requires the Member to provide the disclosure. It is the advisor that forges and maintains the relationship with the client based on trust and personal suitability, and it would seem obvious that the advisor brings a unique perspective on client disclosure, which should be reflected in any mandated requirements.

A concern we would like to raise deals with the policy development process implemented by the MFDA and the justification provided for proposed rules, notices and policies in general. For example, section "B. The Issues" state "[i]n addition, the MFDA has also become aware of a number of other issues with respect to procedures employed by some Members in discharging their supervisory duties in connection with their clients' accounts. As some of the changes to be implemented under CRM relate to issues of supervision and involve the same Rules and Policies, these changes are being brought forward with the CRM proposal". The vague reference to "other issues" appears to us to be insufficient grounds to move forward on rule and policy changes. As a stakeholder, we believe that greater detail is required to justify and legitimize undertaking amendments to policies and rules. Similarly, your section entitled, "DETAILED ANALSIS, Best Interest of the Capital Markets" states, "[t]he Board has determined that the proposed amendments are in the best interests of the capital markets", yet fails to indicate how this conclusion has been reached. We feel that bold conclusions such as these must be supported with concrete information and examples and that these need to be stated in consultation documents for stakeholders to consider.

A final point of concern with respect to information disclosure on the part of the MFDA relates to your statement on a cost/benefits analysis. The MFDA states, "[t]he possibility of conducting a cost/benefit analysis of changes proposed in relation to the CRM project was also discussed. However, no agreement with potential participants was reached regarding the approach to be followed in conducting the analysis". In our view, a cost/benefits analysis is critical in determining if the benefits to be derived from proposed regulatory intervention outweigh the costs associated with the intervention. Regulation will inevitably result in compliance costs that will be passed along to clients. The MFDA disclosure with respect to the cost/benefit analysis increasingly appears to be boiler plate. A cost/benefits analysis is critical in determining if the benefits to be derived from proposed regulatory intervention outweigh the costs. Proper consideration is not being given to assess the costs and benefits of proposed regulation.

We believe that involving stakeholders upon first identifying a problem and providing the facts upon which actions are being taken will result in better two-way communications, greater discussion about the nature of the problem and plausible corrective actions, in addition to greater buy-in from stakeholders when a course of action has been determined. We believe that the MFDA policy process presupposes an adversarial relationship between the regulator and those whom they regulate. We propose a relationship based on mutual respect and inclusiveness. We share with the MFDA the goal of consumer protection. Sharing findings and concerns earlier in the process will allow industry participants to provide supplemental resources by way of their own internal expertise and ideas. We believe that such an approach will enhance the goal of consumer protection and result in more options for consideration at the start of the policy development process.

Advocis' experience in dealing with provincial insurance regulators on issues such as conflict of interest disclosure and product suitability, where potential problems are discussed with advisors early in the policy development process, has yielded principles-based regulation with a high acceptance level of industry stakeholder groups.

MFDA also reference the fact that the Investment Dealers Association (IDA), now the Investment Industry Regulatory Organization of Canada (IIROC), and CSA have been working together to implement various aspects of the Client Relationship Model (CRM) project. Proposed National Instrument 31-103, and in particular the *Conduct Rules*, (NI 31-103) addresses these matters through an outcome-based proposal. In our estimation, neither IIROC nor the MFDA can develop policies and rules on this subject that are totally consistent with NI 31-103, as the latter still remains in the development process. As NI 31-103 is not final it seems counterintuitive for SRO's to draft rules and policies in the absence of a compelling argument of harm to the market or investors prior to the CSA completing its task. We have not seen, nor are we aware of any arguments in this regard. The current process with respect to the CRM adopted by the MFDA is confusing to stakeholders who are following and participating in the formulation of NI 31-103. In future, it would be beneficial for CSA policy instruments that directly impact SRO policies, guidelines and rules to be completed before SROs begin their own consultative process.

Specific Comments on Proposed Amendments to MFDA Rule 2.2 *(Client Accounts)*

Proposed Amendment 2.2.1 (e) is meant to ensure the suitability of the investments within each client's account is assessed when certain events occur. This is new. The Impact to Approved Persons is contained in sub (i) and (ii) and relates to the Approved Person becoming aware of a material change in client information. The second case relates to when there is a change in the Approved Person responsible for the client's account. We believe a principles-based approach would be effective here. In prescribing the events that will require a review of suitability, the risk remains that there could be other potential situations not contained within those enumerated, which may reasonably be viewed as a trigger to a review of suitability. Consideration should be given to leaving the details in a Notice as to the type of events or situations that may trigger the need for a review. Such an approach would be consistent with our belief in a more principles-based approach in trying to achieve a desired outcome. We can see no harm to the client in adopting a more outcomes-based approach in this case.

We note that Rule 2.2.1 (f) is very similar to 2.2.1 (c) with the exception that it is in relation to the investments in the client's account (rather than focusing on the order). We propose that sub (f) be deleted and incorporated into (c).

We are troubled by elements in Rule 2.2.4 (d) which extends the signature requirement to include changes in client address or banking information. As people change their address and banks far more frequently than they change their names it is reasonable to conclude that there will be an increase in the number of client signatures required. Advisors are finding that MFDA rule changes are leading to ever increasing compliance responsibilities and this is a prime example. We can understand the rational for requiring a client signature for a change in name, but we fail to see the broader policy concern being addressed by extending the signature requirement to include changes in address and banking information. We would request that the MFDA consider removing the additional two requirements from the Proposed Amendments.

In relation to the above noted point we are encouraged by the Proposed Amendments to Policy No.2, specifically sections 6 and 7, where it explicitly recognizes that electronic signatures are acceptable.

Specific Comments on Proposed Amendments to Policy No. 2 *Minimum Standards for Account Supervision*

Much of the content of the Proposed Amendments are consistent with Notice MR-0069 which was issued on April 14, 2008. As a general statement, if the notice was viewed as acceptable in April we believe that sufficient time should be allotted to first determine if the Notice will achieve the MFDA's desired outcome before scarce regulatory resources were expended on amending Policy No.2.

The Proposed Policy states, "Members that seek to adopt policies and procedures relating to branch and head office supervision or the allocation of supervisory activities that differ from those contained in this Policy must demonstrate that all of the principles and objectives and minimum standards set out in this Policy have been properly satisfied. Further, any such alternative policies and procedures must adequately address the risk management issues of the Member and **must be pre-approved by MFDA staff before implementation."** This is needlessly prescriptive. Under the current and Proposed Policy, *ESTABLISHING Procedures 4,* the MFDA states, "[a]ll policies established or amended should have senior management approval." Clearly the current Policy demonstrates that management was deemed responsible to determine if their internal policies met the requirement stated in the MFDA Policy. The guidance was just that, guidance. Under the Proposed Amendments, management now requires MFDA pre-approval. This goes beyond guidance and has all the characteristics of a prescriptive rule. We believe that the MFDA has not demonstrated the need for this level of oversight and further feel it is not warranted and should be removed.

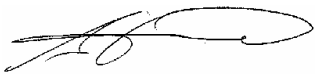
Further, we question the need for 3(p) under the *Documentation of Client Account Information* section of the Proposed Amendments. The general provision in 3 states, "for each account of a client that is a natural person, the Member must obtain information sufficient to allow for the operation of the account and sufficient to determine the essential facts relative to each client (the 'know-your-client' or 'KYC' information), which would include, at a minimum". Our concern is with 3(p) which states, "information required for compliance with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations*, as amended from time to time." The requirements under Money Laundering are federally legislated and compliance is mandatory. Accordingly, 3(p) is an example of unnecessary and duplicative regulation for no apparent benefit, and should be removed. Our members are obliged to comply with Proceeds of Crime legislation and regulation without direction from the MFDA on this matter.

In conclusion, financial advisors are the front line professionals interfacing with clients, introducing products, and establishing long-term relationships and investment strategies that will allow the client to achieve their financial goals. Increasingly, we are seeing regulatory developments that are interfering with this very important relationship that demonstrate a lack of understanding of the client-advisor relationship. We propose that the MFDA engage all interested industry participants whom may be impacted by policy and regulatory undertakings at the outset of the process. A failure to implement an inclusive policy formulation process will result in unintended consequences, policy implementation delays, additional cost to regulators and industry participants, and ultimately the consumer. Regulatory proposals should be accompanied by a robust cost-benefit analysis clearly demonstrating the costs to market

participants and any possible negative impacts on investors in addition to the benefits to investors.

Thank you for providing us with the opportunity to comment on these important matters.

Yours truly,



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