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By-Laws and Regulations

Amendments to Regulation 1300 regarding Managed Accounts

The Board of Directors of the Association has approved amendments to Regulations 1300.2 to 1300.21 regarding managed accounts, to become effective immediately.

Attached is the revised regulation.

The revisions were recommended by the Portfolio Management/Managed Accounts Committee, a joint subcommittee of the Compliance and Legal Section and the Education and Training Committee. The principal changes are:

- The definition of “commingled funds investment portfolio” has been deleted from section 1300.3 as is not referred to in any section of the old or new regulations and is not a feature of existing managed accounts programs.
- The definition of “discretionary account” in section 1300.3 has been changed from including managed accounts to excluding managed accounts. The regulations regarding managed accounts are now restricted to those sections specifying their application to managed accounts. Sections 1300.4 to 1300.6 of the regulations deal solely with discretionary accounts and are no longer applicable to managed accounts.
- The definition of “managed account” in the old section 1300.3 referred to representations made by a Member regarding a type of account. The definition was simplified to describe the actual opening and operation of managed accounts, including that they are solicited and are operated on an ongoing discretionary basis.
- The definition of “responsible person” in section 1300.3 has been changed to remove the Member as a responsible person. The responsible person provisions are directed at controlling conflicts of interest in the management of managed accounts, some of which are

relevant to the Member and some of which are not. The change permits inclusion of the Member directly where a particular provision is applicable to the Member. The definition excludes sub-advisors, i.e. external managers, because they are not within the Association's jurisdiction and because of the same potential for conflict of interest does not arise where the portfolio manager is not an employee of the Member. However, there is a conflict of interest provision applicable to sub-adviser relationships in revised section 1300.7(a)(ii).

- Revised section 1300.7 governs the opening and operation of managed accounts. Subsection 1300.7(a)(ii) has been added to explicitly permit the management of managed accounts by external sub-advisors, provided that they are properly registered in their home jurisdiction in a category permitting them to provide discretionary portfolio management services and that they are subject to regulatory or contractual conflict of interest provisions equivalent to those to which Members are subject under the regulations.

Sections 1300.7(b) and (c) repeat the provisions requiring client authorization and Member approval of the opening of a managed account which previously appeared in Regulation 1300.4 as covering both discretionary and managed accounts. They differ only in that branch managers are permitted under the revised regulation to approve the opening of managed accounts on behalf of the Member. Branch manager approval is appropriate for many types of managed accounts, such as centrally managed accounts in which the essential choice is the type of portfolio, a choice is little different from the selection of securities in a traditional client-directed account.

Section 1300.7(d) contains the requirement previously found in section 1300.12 that clients be provided with a copy of the Member's procedures to ensure the fair allocation of investment opportunities among managed accounts.

- Revised section 1300.8 contains the requirements for a managed account agreement. Sections 1300.8(a) and (b) are new. Section 1300.8(a) requires that the investment objectives specific to the managed account or accounts of the client be delineated in the managed account authorization, so as to separate them from the client's overall objectives for all types of accounts, both managed and self-directed, which may appear on the new client application form. This is important information because the investment decisions for the managed account should relate solely to the managed funds, requiring an explicit separate statement of those objectives. Section 1300.8(b) requires documentation of any constraints placed by the client, if those are permitted by the Member. Sections 1300.8(c) and (d) repeat the termination provisions regarding managed account agreements, which previously appeared in Regulation 1300.4 covering both simple discretionary and managed accounts.
- The previous section 1300.8 has been deleted. It required designation of a specific supervisor for each managed account and disclosure to the client of that supervisor's name.
- Previous section 1300.9A has been changed to revised sections 1300.9, 1300.10, 1300.12 and 1300.13. These sections set forth the requirement for portfolio managers and associate portfolio managers, in both securities and futures contracts, to be approved and the basis for such approval. The requirements have not been changed except for the elimination of the requirement in each case for the applicant to have obtained from the Member a letter of

recommendation signed by the chief executive officer and the partner, director or officer responsible for managed accounts at the Member. The act of sponsoring an applicant for approval as a portfolio manager or associate portfolio manager is indication of the Member's belief that the applicant is qualified. The sections were also rewritten to make it clear that registration within the three years prior to an application by a Provincial securities regulatory authority in a capacity equivalent to portfolio manager or associate portfolio manager is an alternative to the specific proficiency requirements set forth in Policy 6, Part I.

- New section 1300.14 has been added. It is similar to the previous section 1300.7B, changed to section 1300.11. Both sections recognize that, by virtue of their higher proficiency requirements, approval as a portfolio manager or associate portfolio manager provides an expansion of the permission to trade and advise on trading which comes with approval as a Registered Representative, and that therefore portfolio managers and associate portfolio managers are qualified to provide identical trading and advisory services.
- Section 1300.15 sets out the basic supervisory requirements for managed accounts, replacing current sections 1300.8 and 1300.10 to 1300.12. However, instead of prescribing specific supervisory structures, it requires a Member having managed accounts to establish and maintain a supervisory system, including relevant policies and procedures, "reasonably designed to achieve compliance with" all relevant regulations. It also requires that the system be approved by the Association and establishes minimum requirements to be met, including:
 1. procedures to enforce the conflict of interest provisions of sections 1300.18 and 1300.19;
 2. procedures to ensure fairness in the allocation of investment opportunities among managed accounts (required under the previous Regulation 1300.12);
 3. the designation of a partner, director or officer responsible for the supervision of managed accounts, who may delegate supervisory functions but not responsibility;
 4. a quarterly review of each managed account to ensure that the investment objectives of the client are being diligently pursued. This provision is essentially the same as current Regulation 1300.12. However, it has been changed to permit the review to be conducted on an aggregate basis where investment decisions are made centrally and applied across a number of accounts. This change is appropriate for model portfolio accounts which make essentially the same investments and investment changes. In such a case, the review would ensure that any investments and investment changes do not take the model outside of the parameters which would have led the participating accounts to select it;
 5. the establishment of an managed accounts committee to conduct a review, at least annually, of the supervisory system and recommend any appropriate changes. This section replaces previous section 1300.10(a), which required the formation of a portfolio management committee to conduct a quarterly review of the investment policies of the Member. The role of the managed accounts committee under the revised regulation is to conduct, at least annually, a review of the efficacy of the Member's supervisory procedures for managed accounts.

- Revised sections 1300.16 and 1300.17 replace current sections 1300.13 and 1300.13A. They are essentially unchanged other than minor wording changes.
- Revised section 1300.18 replaces previous section 1300.15. Whereas the previous section required the obtaining of an undertaking from responsible persons not to trade or arrange for an associate to trade on the basis of knowledge of trades to be made for managed accounts, the revised section prohibits such activity directly.
- Revised section 1300.19 replaces previous section 1300.16, dealing with possible conflicts of interest in the discretionary management of accounts. It adds investments in futures contracts based on securities subject to the previous provision to take account of the introduction of single-security futures contracts. It also adds a requirement to obtain written consent from the client to invest in new or secondary issues of securities underwritten by the Member. Although research found that few members purchase new issues for managed accounts, it would be unfair to restrict managed account clients from participating in appropriate new issues but that clients should have the option of prohibiting such investments.
- Section 1300.20 is new. It exempts managed accounts of partners, directors, officers and employees or agents of the Member from the client priority rule in By-law 29.3A where such a person maintains a managed account which is centrally managed with client accounts and participates equally with client accounts when investment decisions are implemented. The implementation of decisions for such account usually takes the form of block purchases or accumulations which are allocated on an average price basis. The application of By-law 29.3A to such investments is unnecessary, as the participation of non-client managed accounts is generally minor, the investment decisions are not being made by the employee account holder, who cannot therefore take advantage of client orders, and the separation of non-client accounts makes the implementation of investment decisions unnecessarily complicated.
- Section 1300.21 remains unchanged.

Kenneth A. Nason
Association Secretary