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For distribution to relevant parties within your firm

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By-Laws and Regulations

Capital Provisions for Unresolved Mutual Fund Differences - Revisions to the Notes and Instructions to Statement B of Form 1

Background

Where a third party holds client assets on behalf of an investment dealer, the investment dealer has a responsibility to ensure that the entity holding the assets exercises its custodial responsibilities in a responsible manner. The investment dealer has a further responsibility to reconcile its books and records to the records of the third party custodian on a regular basis.

Specific to mutual funds, a general standard has been implicitly established for the reconciliation of investment dealers' records to the records of third parties holding client assets on behalf of investment dealers. This standard calls for monthly reconciliations. However, many mutual funds do not provide information to investment dealers on a monthly basis that would allow them to perform monthly reconciliations. It is reasonable that investment dealers should be required to make a provision of capital for possible losses as a result of the inability to regularly reconcile its records to the records of mutual fund companies. However, since the investment dealer is not responsible for its inability to reconcile its records to the records of mutual fund companies on a timely basis, it is also reasonable to reduce such capital provision where the investment dealer has taken reasonable steps to reduce the reconciliation risk.

Steps that an investment dealer may take to reduce these risks include:

- not selling the mutual fund to its clients; and
- not lending money to its clients based on the value of such mutual funds.

Rule Change

To reduce the capital provision where the investment dealer has taken reasonable steps to reduce the reconciliation risk, the notes to Statement B of Form 1 have been amended as attached, **effective November 30, 1999**. The amendment specifically requires that where mutual fund positions are not reconciled on a monthly basis, capital shall be provided equal to a percentage of the market value of such mutual funds held on behalf of clients. Where no transactions in the mutual fund other than redemptions and transfers have occurred for at least six months and no loan value is associated with the mutual fund, the percentage shall be 10%. In all other cases the percentage shall be 100%.

The amended rule also requires investment dealers to provide capital for potential losses relating to possible losses associated with the lack of monthly reconciliations of its records to the records of mutual fund companies holding client assets on behalf of the investment dealer.

Further, it also provides incentive to the investment dealer to take steps to reduce the risk of loss inherent in not reconciling client mutual fund assets monthly, while giving some recognition to the fact that the lack of monthly reconciliations is not the fault of the investment dealer.

Lyn M. Gilchrist
Association Secretary

**INVESTMENT DEALERS ASSOCIATION OF CANADA
RECONCILIATION OF CLIENT MUTUAL FUND POSITIONS**

The BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

The note to Line 19 of Schedule B of the Joint Regulatory Financial Questionnaire and Report is amended by adding the following paragraph:

Where mutual fund positions are not reconciled on a monthly basis margin shall be provided equal to a percentage of the market value of such mutual funds held on behalf of clients. Where no transactions in the mutual fund other than redemptions and transfers have occurred for at least six months and no loan value has been associated with the mutual fund, the percentage shall be 10%. In all other cases the percentage shall be 100%.