

## MEMBER REGULATION



INVESTMENT DEALERS  
ASSOCIATION OF CANADA

# notice



ASSOCIATION CANADIENNE DES  
COURTIERS EN VALEURS MOBILIÈRES

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**MR0207**

*April 8, 2003*

**ATTENTION:**

Ultimate Designated Persons  
Chief Financial Officers  
Panel Auditors

**Distribute internally to:**

- Corporate Finance
- Credit
- Institutional
- Internal Audit
- Legal & Compliance
- Operations
- Registration
- Regulatory Accounting
- Research
- Retail
- Senior Management
- Trading desk
- Training

### **Processing of Segregated Fund Contracts**

This notice is the culmination of a review done jointly by a sub-committee of the Canadian Life and Health Insurance Association (CLHIA) and IDA staff as well as expert staff of member firms. This review was undertaken to ensure that segregated funds contracts processing at member firms remains in compliance with IDA regulations while at the same time adhering to the legal and regulatory provisions of the Insurance industry. Although there will be some changes to the manner in which the Manufacturers will process segregated funds contracts, the conclusions reached were that these changes will be transparent to member firms from the processing perspective, whether the trades are for Registered or non-Registered accounts. This means that Manufacturers will continue to accept trades entered through FundSERV on a Nominee basis, and report the accounts and positions on all FundSERV files (AO, AT, AF & AM) as Account Designation 2, being Broker Nominee. As well, members may continue to display segregated funds contract positions on their client statements on a Nominee basis (i.e. registered in broker name).

Financial Compliance Notice FC98-29, originally published on December 22, 1998, set out the circumstances in which Members would be permitted to report segregated fund contracts on client statements. That Notice specifically avoided addressing legal and regulatory implications that might arise from marketing or administering the distribution of segregated fund contracts, which are contracts of life insurance, through a Member.

We have reviewed the operation of the Notice with the CLHIA and have determined that our regulatory objectives can be met with further clarification of matters addressed in the Notice that will better reflect the legal and regulatory provisions applicable to these products. The principles underlying the processing of segregated fund contract transactions by a Member are as follows:

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- (1) Segregated fund contracts are life insurance contracts between the insurer and the client. Such contracts are sold by licensed life insurance agents, who may be related to a life insurance agency. Any Member involvement in transmitting instructions or premiums to the insurer is solely as agent of the client pursuant to the terms of an account opening agreement or supplementary authorization. The Member, by acting as agent for the client, does not hold the segregated fund contract “in trust,” bare or otherwise, for the client.
  - (2) Where segregated fund contracts are held in a self-directed registered plan, the life insurance contract is a qualified investment that is purchased by the trustee. The insurance company should issue the contract to the trustee as such and not as a registered insurance contract.
  - (3) Members who are processing segregated fund contract transactions do so pursuant to an agreement to provide accounting and custody services to the insurance agency whose representative sold the segregated fund contract to the client.
  - (4) Segregated fund contracts are contracts of life insurance and as such are not “securities.” We understand that insurers contract with insurance agencies that are affiliated with Members to distribute the insurers’ segregated fund contracts and that these affiliated insurance agencies engage the services of the Member to process such transactions using the Member’s systems and FundSERV. In these circumstances, the Member is processing segregated fund contract transactions as a provider of accounting and custody services for an affiliated insurance agency.

Clients of Members and their affiliated insurance agencies desire to consolidate their insurance and security transactions into a single set of statements. Accordingly, we will permit reporting of information and confirmations regarding transactions in segregated fund contracts on client statements prepared by the Member under the following circumstances:

1. The Member’s client documentation, whether in an account opening agreement or in a supplementary authorization:
  - (i) specifically authorizes the Member to act as exclusive agent for the client in transmitting instructions to the insurer with respect to segregated fund contracts; and
  - (ii) provides that the client acknowledges that the Member is not engaged in the sale of life insurance products and acknowledges the relationship between the Member and the life insurance agency responsible for the life insurance representative engaged in the sale.
2. The Member enters into a servicing agreement with the insurance agency for which it processes segregated fund transactions. This servicing agreement must specify that the Member is engaged to open client accounts and process such transactions on behalf of the insurance agency and prepare confirmations and statements, where applicable, with respect to such insurance transactions on behalf of the insurance agency.
3. Premiums should be paid by the client to the Member with instructions to transmit the premium to the insurer as agent for the client.
4. The individual selling the segregated fund contract is a licensed life insurance agent in the province in which the sale takes place.

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5. Commissions payable on the sale of segregated fund contracts shall be processed through the Member provided that its obligations to do so are set out in an agreement between itself and the insurance agency as described in section 2.
  6. Segregated fund transactions must be clearly and reliably identified so as to distinguish insurance transactions from securities transactions.
  7. Where the segregated fund contract is issued to a self-directed registered plan, it must be recorded by the insurer in the name of the trustee of the plan and the client must be recorded as the beneficial owner of the plan. Where the Member is providing instructions with respect to the segregated fund contract on behalf of the trustee, the contractual arrangement between the Member and the trustee must authorize the Member to do so.

Where the segregated fund contract is issued on a non-registered basis, the contract must be shown as owned by the client on the insurance company's records and the Member recorded as exclusive agent of the client for purposes of policy transactions with the insurance company. Where the Member is acting as exclusive agent for the client, the Member must ensure that this relationship is appropriately established in the account opening agreement or otherwise.

8. The Member, in processing segregated fund transactions for the insurance agency and in transmitting client instructions with respect to the segregated fund contracts, abides by appropriate controls and procedures, including those required by insurers or applicable insurance laws, regulations or guidelines. The Member will apply the same controls and procedures as apply to the processing of mutual fund or security transactions except where to do so conflicts with applicable insurance regulations or where the controls and procedures are inapplicable to the product.

This Notice provides further clarification with respect to segregated fund transactions contemplated in Notice FC 98-29 dated December 22, 1998. As such, Notice FC 98-29 remains in effect, subject to this clarification. Although care has been taken to accommodate the fact that segregated fund contracts are contracts of life insurance, each insurer and insurance agency affiliate of a Member processing segregated fund transactions through a Member must be satisfied of its own compliance with applicable insurance laws, regulations and guidelines. In addition, this bulletin makes no statement with respect to the implications of this process on certain aspects of life insurance contracts, including probate status and creditor protection features and Members should consult legal counsel with respect to these matters.