Investment Dealers Association of Canada / Mutual Fund Dealers Association of Canada

Joint Arrangement Project

Report from the Joint Committee

To the

Ontario Securities Commission

November 3, 2004

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Executive Summary

The market for financial services has undergone significant changes over the past several years. In an effort to meet client expectations and competitive demands, many arrangements have developed between dealers and other financial service providers to make available a wider array of services than any one company could provide on its own. However, regulatory staff raised concerns about the possible implications of some arrangements between mutual fund dealers and investment dealers to allow clients of the mutual fund dealer to hold assets, other than those that the mutual fund dealer may deal in directly, while maintaining their relationship with the mutual fund dealer.

This joint industry committee of Investment Dealers Association of Canada ("IDA") and Mutual Fund Dealers Association of Canada ("MFDA") members (the "Committee")[1] was established to review the issues raised and propose solutions. The Committee's discussions focused on identifying models that would meet the needs of the clients involved, address the regulatory concerns identified and work within the existing structure of securities regulation and the SRO rules.

None of the issues raised by joint arrangements are new. Acting beyond licensing restrictions, client confusion and identification of client assets in the event of insolvency arise in the delivery of most financial services. The Committee is of the view that, within an appropriately structured arrangement, these challenges can be addressed adequately by a combination of client disclosure, training of sales representatives, internal policies and procedures to limit the opportunities for improper actions, supervision at the firm level to detect breaches and oversight by the relevant SRO and securities commissions. In developing potential alternatives, the Committee considered other arrangements that currently exist within the securities industry and hopes the Commission will also view these alternatives in the same context.

The Committee has identified two models that we believe respond to the issues raised by regulators with certain types of arrangements.

- The service provider model deals with the situation where the activities for the mutual fund dealer's clients are limited to assets that the mutual fund dealer is permitted to trade, but where the dealer cannot hold/process the trades in certain classes of these securities. Under this model, an investment dealer essentially would serve as its affiliated mutual fund dealer's back office. The investment dealer would execute, clear and settle trades, hold securities and keep the appropriate books and records for the mutual fund dealer entirely separately from the transactions done for the investment dealer.
- The second model applies to registered retirement savings plans (RRSPs) where the client wishes to hold both permitted assets and prohibited assets in a single registered plan. Under this model, a single plan would be established with a trustee, with two associated trading accounts – one at an investment dealer and one at a mutual fund dealer.

The Committee believes that there may be acceptable structures in addition to those identified that should be permitted, provided certain conditions are met. In particular, the introducer/carrier

[1] A list of Committee members appears at the end of this report.

model should be made available for permitted assets once the MFDA becomes a participating institution in the Canadian Investor Protection Fund ("CIPF").
If these new structures are acceptable to the Commission, the Committee suggests that the immediate next steps by the IDA and MFDA would be to:

- Publish a joint notice setting out the approved structures and giving all dealers with these arrangements in place a deadline by which they would have to present a plan to the SROs either to convert their arrangements to an approved structure or wind the accounts down.
- Draft the appropriate information sharing MOU based on international standards.

Given the very short period of time to December 31, 2004, the Committee would recommend that the SROs and the OSC agree to give the affected dealers a reasonable period to carry out the transition to acceptable arrangements.

Introduction

The past decade has seen significantly greater participation by individuals in the securities market through investing in mutual funds or via direct investment in equities and debt instruments. As the investment knowledge of these retail investors has increased, so too have the demands placed on their investment professionals to provide a full range of products and services. However, the laws governing the provision of financial services often require the involvement of more than one licensed entity to provide "one stop shopping" for clients. At a corporate level, the drive to provide a single source for all client needs is one of the primary reasons for the formation of financial conglomerates. At the individual firm level, client expectations and competition have spawned a number of formal and informal arrangements between dealers and other financial service providers to produce the same range of services.

Concerns were raised about the possible implications of certain arrangements that have developed between mutual fund dealers and investment dealers to accommodate the desire of clients of the mutual fund dealer to hold assets, such as equities, in which the mutual fund dealer is not permitted to trade ("prohibited assets") while maintaining their principal relationship with the mutual fund dealer. The regulators' key concerns related to:

- The mutual fund dealer and its representatives acting beyond the limitations on their registration category;
- Client confusion regarding respective roles, responsibilities and liabilities of dealers involved; and
- Lack of compensation fund coverage for the assets of the mutual fund dealer client held at the investment dealer.

At the request of the Ontario Securities Commission ("OSC"), in February 2003 the IDA and MFDA undertook a joint project to analyse the arrangements in place and make recommendations to address any regulatory issues identified. The report was delivered to the OSC in September 2003.

The report confirmed the previously identified concerns about these structures and in June of 2004, by agreement among the IDA, MFDA and OSC, the two self regulatory organizations ("SROs") published a joint notice to their members. The notice imposed a moratorium on new business using these arrangements and warned that the existing arrangements might have to be unwound by December 31, 2004. The SROs also established this Committee to review the issues and propose solutions. At the same time, the OSC staff published an issues paper outlining their

concerns and solicited public comment on a series of questions.[2] Further, in August the OSC held a roundtable to discuss these issues.

The Committee's discussions focused on identifying models that would meet the needs of the clients involved, while addressing the regulatory concerns identified by the OSC staff. Because we were looking for models that could be implemented as quickly as possible, we worked within the existing structure of securities regulation and the SRO rules. We did not assume that significant policy changes would be made to these requirements. For example, we assumed that the MFDA would have to join CIPF before formal introducing/carrying broker arrangements could be put in place between mutual fund dealers and investment dealers.

None of the issues raised in connection with joint arrangements are unique to these structures. The compliance challenge facing all financial service providers is finding the right combination of disclosure, appropriate education of clients and staff, internal policies and procedures and supervision at the firm level to reduce client confusion, ensure everyone understands the services that may be provided, limit the opportunities for improper actions and detect breaches. There is no reason to believe that the issues identified in connection with the joint arrangements between mutual fund dealers and investment dealers require materially different responses.

Generally, the Committee believes that there may be acceptable structures in addition to those identified here that should be permitted, provided that they are properly structured. In our view, regulatory policy should seek to strike a balance between investor protection needs and freedom in the market that will give fully informed clients the ability to choose the products and services they want at an appropriate cost. We believe that such a balance can be achieved in this case. Even the most pervasive regulatory regime cannot eliminate all risk that the rules will be breached and such a regime would impose great costs on the market (ultimately be borne by investors) for a minimal increase in investor protection.

It should also be noted that if one or more formal structures are not developed to accommodate these arrangements, they may simply move completely off-book and therefore be even more difficult to police by the dealers and regulators. The better course would be to define acceptable alternatives, actively monitor compliance and promptly punish those who breach the rules.

Types Of Existing Arrangements

In general, the problematic structures fall into one of two types – joint service arrangements and omnibus account structures.

In joint service arrangements, an account is opened for the client at an investment dealer, while most of the direct client contact takes place by a registered representative of the investment dealers' related mutual fund dealer. The investment dealer performs all the back office functions and client statements are issued in the name of the investment dealer. In essence, the mutual fund dealer salesperson is acting as a representative of the investment dealer. While the mutual fund dealer salesperson only trades in or gives advice on assets that the particular mutual fund dealer is permitted by law to trade[3] ("permitted assets"), the account may contain equities or other

[2] Staff Notice 31-712 *Mutual Fund Dealers Business Arrangements*, [2004] 27 OSCB 5623 (June 11, 2004).

[3] "permitted assets" includes mutual fund securities for all mutual fund dealers and any other instruments that the mutual fund dealer is licensed, registered or otherwise permitted to trade in by law. In most provinces, the term would encompass exempt market securities, such as government

prohibited assets.[4] Trading in prohibited assets is done through a representative of the investment dealer. Just the investment dealer or both dealers may carry out trade supervision.

Most of the arrangements between mutual fund dealers and investment dealers to transact in, and hold prohibited securities for the mutual fund dealer's clients fall into the omnibus account structure. In an omnibus account arrangement, when a mutual fund dealer's client wants to buy or sell prohibited securities, that client is referred to an investment dealer. A delivery against payment ("DAP") account is opened at the investment dealer and the trade is executed through a registered salesperson at that investment dealer. Once the trade is settled, the proceeds from a sale or securities from a purchase are transferred from the client's DAP account to an omnibus account for the mutual fund dealer at the investment dealer. The assets then are shown on the client's account statements at the mutual fund dealer. In effect, the mutual fund dealer is holding the prohibited assets on behalf of its clients with the investment dealer acting as (sub)custodian.

Proposed Models

The Committee has identified two models that we believe warrant further consideration; one because it addresses the issues raised by the OSC staff with certain types of arrangements and the other because it meets a perceived client need. Unfortunately, neither of these models will be particularly cheap or quick to implement and both have their limitations.

The first of these models applies to the situation where the trading activities for the mutual fund dealer's clients are limited to permitted assets, but for some reason, such as systems limitations, the mutual fund dealer cannot hold/process the trades in certain classes of these securities – such as third party mutual funds or government fixed income securities. The second model applies to registered retirement savings plans (RRSPs) where the client wishes to hold both permitted assets and prohibited assets in a single registered plan while dealing with both a mutual fund dealer and an investment dealer.

A formal introducing broker/carrying broker model is not being put forward at the present time, as there are some significant impediments to the use of this structure. The current IDA rules require both the introducer and carrier to be members of an SRO that is a participating institution of CIPF. While becoming a participant in CIPF is a long-term goal of the MFDA, it will take some time to achieve. Also, the present introducer/carrier model contemplates that only one registered representative deals directly with the client and that representative is located at the introducer. If the client wished to trade securities other than permitted assets, a registered representative located at the carrier would have to be involved, which would require significant changes to the present structure.

a. Back-Office Service Provider Model

This model is described in the IDA's proposed Member Regulation Notice, *Consolidation of Back-Office Operations of a Member Firm and its Affiliates* (the Notice). The Notice is attached as Appendix A. The IDA already permits consolidation of back office operations between an

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bonds and guaranteed investment certificates, without the dealer having to hold any additional registration. In Ontario and Newfoundland, the mutual fund dealer would have to be registered as a limited market dealer to carry out trades in these securities.

[4] In one case, only permitted assets may be held in the joint service account at the investment dealer. A separate account at the investment dealer must be opened if the client wishes to trade prohibited assets.

IDA member and any of its affiliated Canadian financial institutions[5] subject to the same terms and conditions as set out in the Notice.

Under this model, the investment dealer performs all the back-office tasks for its affiliated mutual fund dealer – including trade executions, trade settlements, keeping the required records and producing the appropriate reports. The activities carried on for the mutual fund dealer are done in an entirely separate set of accounts in the name and for the account of the mutual fund dealer. Cash and securities in the accounts of each dealer must also be maintained separately, under the control and in the name of the individual dealer involved. The key is that there would be no commingling of customer assets under administration by either the investment dealer or its affiliated mutual fund dealer.

The mutual fund dealer would remain responsible to the securities commissions, the MFDA and the client for compliance with all SRO and legal requirements applicable to mutual fund dealers, including "know your client", sales compliance and capital requirements. The client account would be opened at the mutual fund dealer (not the investment dealer) and all confirmations and account statements would be in the name of the mutual fund dealer. The model works for all types of mutual fund dealer accounts – both direct trading accounts and self-directed RRSP accounts. The only modification for the RRSP accounts would be that the cash in the accounts would have to be transferred to the RRSP trustee, rather than held in trust at the dealer's usual deposit-taking institution.

The services of the investment dealer service provider, like those of the electronic data processing service bureau (ISM, ADP or Dataphile) or the bank holding the trust account for the mutual fund dealer, are not visible to the mutual fund dealer's clients. As far as the client is concerned, the only dealer involved is the mutual fund dealer. Since the client has no knowledge of the involvement of the investment dealer, the likelihood of a client becoming confused about which company is providing what service or the investor protection coverage applicable is largely eliminated.

These service provider arrangements would require the prior approval of each of the IDA and MFDA and all other criteria set out in the Notice would have to be fulfilled. There would have to be a written contract between the dealers involved spelling out certain terms, such as their respective responsibilities, access to information at the other dealer, termination provisions, arrangements regarding confidentiality of client data, business continuity assurances etc. In addition, to ensure there is no issue regarding the ability of an SRO to access information at the other SRO's member, the Committee would recommend that the IDA and MFDA enter into a formal information sharing and mutual assistance memorandum of understanding.

Under this model:

- The mutual fund dealer and its representatives are only dealing with permitted assets, so there is no issue of trading beyond the limitations on the registration category.
- There is no commingling of securities, transactions or cash and the records at the investment dealer clearly identify which client assets / transactions belong to each dealer. The insolvency of one of the dealers should therefore pose no greater challenge regarding identification of client assets than that for any other dealer insolvency.
- The role of the investment dealer service provider is not visible to the mutual fund dealer client, so there should be no issue about client confusion.

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5 See IDA Member Regulation Notice No. MR 0291 dated May 21, 2004.

- The model is not contingent upon the MFDA becoming a participating institution in CIPF.
- If the arrangement between the dealers is structured as required in the Notice, the investment dealer's role is not objectionable to CIPF.
- The sophisticated back office systems and capacity at the investment dealer are leveraged, which may be less costly than replicating these systems at the mutual fund dealer. The service provider is a registered entity, so the issue of the OSC (or other commissions) not having access to the records held at the service provider will not arise.
- Potentially there may be more oversight of the back office systems being used by the mutual fund dealer as the service provider will be subject to IDA oversight generally, the specific audit of internal controls required by the Notice and any review done by the MFDA in connection with its oversight of its Members.

Appendix B contains a chart setting out the regulatory concerns that have been expressed regarding joint service arrangements and detailing how each concern is met by this model.

Difference from Introducing/Carrying Broker Arrangements. In an introducing/carrying broker arrangement under IDA by-law 35, the carrying broker assumes direct responsibility for fulfilling most or all of the financial requirements of the introducing broker. For example, in a Type 1 arrangement, the carrying broker is primarily responsible for meeting the financing requirements of introduced accounts and the client accounts appear on its balance sheet. The two dealers also have joint and several responsibility for non-financial (i.e. sales compliance) requirements. The role of each dealer is disclosed to the client and the names of both dealers appear on the account statements and trade confirmations.

In the service provider model, the mutual fund dealer would remain solely responsible to its clients, the regulators and the MFDA for all sales and financial requirements. While certain back office tasks would be assumed by the service provider, its role would be administrative. The client accounts would be located at the mutual fund dealer and the client would deal solely with the mutual fund dealer.

The Committee notes that this service provider model is somewhat limited in utility, as the Notice only contemplates these arrangements being permitted between affiliated companies. However, the regulators have indicated that they view this limitation as necessary to ensure disputed transactions and other problems will be solved promptly.[6]

The Committee expects that when the MFDA becomes a participating institution in CIPF these arrangements will be converted into formal introducing/carrying broker arrangements. At that time, the MFDA would introduce new rules patterned on IDA By-law 35 that presently governs these arrangements carried on by IDA members. There may also have to be some amendments to the IDA by-law.

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6 The back office consolidation model significantly changed the rules regarding sharing back office databases across legal entities. The previous requirement for separate databases and broker numbers with a service bureau was enforced to ensure that there would never be a single journal entry for money or securities that would affect two legal entities. In other words, the prohibition on sharing was a "preventative" control. The concept set out in the Notice of using the same database for more than one legal entity recognizes that there may be errors between the legal entities but imposes extensive "detective" controls that must be performed on a timely basis to ensure that any errors are corrected immediately. The regulators limited these arrangements to affiliated entities because of the need to have total control to correct an error.

b. Registered Accounts Holding both Permitted and Prohibited Assets

In order to make most effective use of the foreign investment limits for registered retirement savings plans (RRSPs), all registered assets of the client should be held in a single plan. However, this is difficult to accommodate at a mutual fund dealer if an account that is being transferred in already contains prohibited assets or an existing client decides they wish to be exposed to a particular segment of the marketplace that is only available via the purchase of a prohibited asset. Requiring all securities, other than permitted securities, to be disposed of prior to an account transfer being accepted by the mutual fund dealer may not be in the client's interests and may raise questions about the appropriateness of the advice that is being given to the client. Shifting the whole account to an investment dealer and severing the ties with the mutual fund dealer representative when the client wants very limited exposure to prohibited assets may not meet the client's needs or be what the client wants. Splitting the account simply doubles the annual plan fees and the accounts have to be reported separately so that it may not be possible to take full advantage of foreign content limits.

Two (sub)-Accounts, One Registered Plan Model. The model is a variation of the original form of self-directed RRSP operated by trust companies directly.[7] A single plan would be established with a trustee, where each participating client has two accounts – one with a participating mutual fund dealer and one with an investment dealer. Each account would have to meet all usual account opening and sales compliance requirements of the respective SROs, and the client trades would go through a duly registered representative at each firm. The assets of the plan would be purchased and sold by the mutual fund dealer for permitted assets and by the investment dealer for prohibited assets. Custody of the assets, other than cash, could be combined at the trustee or the trustee could leave the securities at each dealer under a sub-custodial arrangement.[8] Cash would continue to be held by the trustee as required by the taxation authorities. The two accounts would be consolidated at the plan level for compliance with the Income Tax Act requirements (reporting, foreign content rules etc.).

Under this model:

- The client would have a single plan containing all registered assets, get a single plan statement covering the entire portfolio and have the maximum flexibility in the use of the foreign content limit.
- The client may retain the relationship with the mutual fund dealer and its registered representative while having the freedom to invest in a wider range of assets.
- The client would be serviced by representatives licensed to trade in the products held within the particular client account.
- There would be no commingling of client assets between the dealers.[9] All transactions are kept in separate books and records, and reported on via separate client statements for

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[7] Under these arrangements, the plan account was set up with a trustee that acted as administrator and custodian of all plan assets. The client then established one or more accounts at the dealers of his/her choice and arranged that trades were settled by delivery against payment at the trustee. This type of account continue to exist.

[8] As noted below, in the traditional trust company model RRSP, if the trustee holds the securities, no contingency plan would apply if the trustee became insolvent except for CDIC insurance for the cash.

[9] Client assets from each dealer will be commingled at the trust company, if the trust company acts as custodian. However, in this case, the assets should not be affected by the insolvency of either

each account making up the registered plan. From the perspective of the dealer or its SRO, trading in the RRSP account would be supervised in the same way as all other accounts at that dealer.

- The dealers would institute appropriate internal controls to reinforce the limitations on the activities permitted to the mutual fund dealer and its representatives (for example, the investment dealer would not accept trading instructions initiated by the mutual fund dealer or its registered representatives). All three firms would have internal controls to ensure all orders were correctly processed through the dealers.
- The investment dealer performs all trading activities for the prohibited assets and either the investment dealer or the trust company performs all other activities relating to these assets, such as acting as custodian, that OSC staff have indicated may be considered as "acts in furtherance of a trade" when performed by a mutual fund dealer in certain circumstances.

The model does not completely address a number of the concerns raised in connection with some of the existing arrangements. Nonetheless, the Committee believes it warrants consideration because it is the only solution that addresses the needs of some clients. These remaining issues would have to be addressed by a combination of policies and procedures at the dealers and disclosure to the clients.

The issues raised by this model are:

- There is potential for client confusion as to the roles and responsibilities of the three parties: the mutual fund dealer, investment dealer and trustee. The receipt of statements covering the same assets from the dealers and the trustee could exacerbate the confusion.
- The two dealers and the trustee would have to put the necessary technology and other infrastructure in place so that each could fulfill its responsibilities for the plan. In particular, the appropriate reporting systems must be in place between each dealer and the trustee so that the client receives accurate statements and the trustee can carry out its administration responsibilities and ensure compliance with the taxation rules. The greater the number of trustee duties delegated to a dealer, the more technologically demanding the arrangement will become. The expenses involved could in turn impact on the fees charged to clients, although they may be saved the alternative of paying fees to two different dealers.
- There is a gap in the regulation of registered plans. As drafted, Ontario Policy 4.3 only applies to investment dealers operating self-directed RRSPs. In 1998, the Canadian Securities Administrators published draft National Instrument 33-101 *Administration of Self-Directed RRSPs, RESPs and RRIFs by Dealers* (NI 33-101) updating OP 4.3 and broadening its application to most tax-advantaged plans and to all dealers. NI 33-101 has never been finalized. Accordingly, in order for this arrangement to work, the highest SRO requirements would have to be met.
- If the securities are held at the trustee, they would not be covered by either CIPF or the proposed MFDA compensation plan.
- While the assets would be held in one plan, no one dealer would be providing overall advice and there would be a potential for conflicting advice regarding such matters as switching the mix of prohibited and permitted securities. If the

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dealer. In any event, once the assets are delivered to the trustee/custodian, no CIPF coverage would apply.

arrangement involves a mutual fund dealer and a discount investment dealer, the temptation for the mutual fund dealer representative to go beyond his or her registration in providing advice would still be an issue, with the alternative that the client would receive no advice on the prohibited assets.
- There is no guarantee that all of the RRSP requirements under taxation legislation would be met by this structure. One Committee member had previously obtained a legal opinion indicating that with an appropriately drafted declaration of trust this two account, one plan structure would be in compliance with those requirements. The Committee did not engage legal counsel to confirm this view. The parties considering establishing such a structure would be advised to consult their own counsel.

Appendix C contains a chart detailing how this model addresses the regulatory concerns that have been expressed.

Next Steps

If these new structures are acceptable to the Commission, the Committee suggests that the immediate next steps by the IDA and MFDA would be to:

- Publish a joint notice setting out the approved structures and giving all dealers with these arrangements in place a new deadline by which they would have to present a plan to the SROs either to convert their arrangements to an approved structure or wind the accounts down.
- Draft the appropriate information sharing MOU based on international standards.

Transitional Period.

The joint notice published in June, 2004 sets December 31, 2004 as the date by which all existing omnibus and joint service arrangements between investment dealers and mutual fund dealers would have to be restructured or unwound. Forcing all restructuring to be completed by this deadline may not be in interests of the affected clients. Even for those mutual fund dealers that simply choose to transfer all accounts containing any prohibited assets in their entirety to an investment dealer, the time required to contact the affected clients, explain the circumstances and get the appropriate approvals will likely be more than time left to the deadline. For registered accounts the deadline is particularly troublesome, as it signals the start of RRSP season when account transfers are particularly difficult. For those dealers that choose to adopt one of the models proposed in this paper, the systems and other back office changes necessary will take a significant period of time to implement.[10]

The moratorium on setting up new arrangements or accepting new clients into existing arrangements set out in the joint notice coupled with the transition plan process contemplated in the Next Steps section above should provide sufficient controls on the existing arrangements during the time it takes to make an orderly transition to new arrangements. The Committee would also expect that the MFDA would continue to monitor the particular operations of affected members during compliance examinations. Therefore, the Committee would recommend that the

[10] See for example, the comments contained in the response letter to the Issues Paper published by OSC staff in June 2004 (Staff Notice 31-712) filled by McCarthy Tétrault dated July 15, 2004.

December 31, 2004 deadline be extended to give all affected dealers a reasonable period to carry out the transition to acceptable arrangements.

Final Remarks

As stated above, the Committee believes that there may be other acceptable structures that should be permitted, provided that they are properly structured. In particular, the Committee discussed the issues presented by the omnibus account arrangements in some detail. Most of these challenges are similar to those that all dealers face, regardless of registration category, in ensuring that their staff are giving appropriate advice and are not engaged in activities outside the limits of their licensing.

The Committee developed a list of additional terms and conditions that might be applied to the omnibus account arrangement to cover off heightened concerns regarding client confusion and to reduce further the opportunities for inappropriate involvement of the mutual fund dealer and its representatives. These are set out in Appendix D, as is a chart detailing how this model could meet the regulatory concerns that have been expressed.

The Committee is not formally proffering this "new and improved" omnibus account structure at this time because we could not find an immediate solution to two staff concerns:

a. The lack of CIPF coverage for clients' assets held in the investment dealer's omnibus account; and
b. The view that arranging for an investment dealer to hold prohibited assets in an omnibus account in the name of the mutual fund dealer and showing those securities on the client's mutual fund account statement constitutes acts that can only be performed by an investment dealer as they are "acts in furtherance of trades" in those securities.

We note that the coverage provided by CIPF is the exception rather than the rule in Canada. Assets held at mutual fund dealers are presently not subject to any general investor compensation fund coverage. The compensation available in the event that a mutual fund dealer fails and a client suffers losses as a result varies from nothing in some provinces to a very minimal amount in others. Non-cash assets held in RRSPs at trust companies and banks are not covered by any compensation fund. Canadian dollar cash assets at most of these financial institutions are covered by CDIC to a maximum of $60,000.

However, since the final meeting of the Committee, the board of the MFDA has decided to institute a compensation fund for MFDA Members that would provide coverage for mutual fund dealer accounts equivalent to that provided by CIPF: that is, up to $1 million coverage for all assets of any kind held in a client account with an MFDA member dealer. The board also decided that the MFDA should pursue becoming a participating institution in CIPF and the new MFDA fund will be established with the intention of merging it with CIPF in the future.

When the MFDA compensation fund is established, the issue of lack of CIPF coverage for the omnibus account will be moot, as the MFDA compensation fund will cover these assets. The investment dealer will be an acceptable custodian for mutual fund dealer assets (or using the terms in the MFDA rules, the investment dealer will be an acceptable securities location) and so the assets held at the investment dealer will be covered by the MFDA fund. If the investment dealer failed, and the mutual fund dealer did not, the mutual fund dealer would continue to be responsible to its client to deliver the assets on demand. If the mutual fund dealer failed, the investment dealer would likely be unaffected, and the assets should be readily available to deliver

to the mutual fund dealer's clients. If the assets had been misappropriated by the mutual fund dealer or were otherwise unavailable, the clients would be compensated by the MFDA fund. If the failure of one dealer triggered the failure of the other, each fund would compensate the losses incurred by their respective dealer's clients.

Rebutting the staff concern about the mutual fund dealer "acting in furtherance of trades" in prohibited securities in these arrangements is somewhat more challenging, given the very wide scope that the term may encompass. Where the client acquired the prohibited assets before the relationship was established with the mutual fund dealer and the actual custodian is an investment dealer, the role of the mutual fund dealer is essentially administrative. It simply arranges for the holding of those assets and reports the position(s) on the client's account statement, like establishing a safekeeping arrangement with a trust company or a bank, only at a far lower cost to the client and with the same compensation plan coverage. Custody is not generally looked upon as a registerable activity: the relevant back office staff of a dealer are not individually registered and entities that hold securities on behalf of others are not registered under securities legislation.[11] Both securities regulation and SRO rules require dealers to report all securities held for clients on the clients' statements of account – even if those securities are held in custody elsewhere, such as under a safekeeping agreement at an acceptable location under the control of the dealer. If there is any residual concern about the mutual fund dealer not having the technical capacity to hold these assets, this should be allayed by the delegation of the activity to the investment dealer.

Where the client wishes to acquire prohibited assets after the relationship has been established with the mutual fund dealer and does not want to simply open a regular account at a discount broker for this purpose, the question of the mutual fund dealer acting outside the limitations on its registration get back to the actual activities undertaken. Setting up the omnibus arrangement and referring a client are primarily administrative activities, and which should not trigger a need for investment dealer registration, provided there is no active involvement in recommending the transaction. Ensuring that these representatives are staying within the limits of their registration and comply with all other legislative and SRO requirements is the same compliance task facing all dealers.

If the Commission takes the view that the role of the mutual fund dealer doesn't automatically trigger the need to be registered as an investment dealer, the Committee is of the view that an omnibus arrangement incorporating the specific terms and conditions set out in Appendix D should not be objectionable from a regulatory perspective once the new MFDA fund is established. In fact, at the present time there are other analogous arrangements in place – largely for RRSP accounts - where all assets are held at a trust company. Our understanding is that these arrangements were structured after specific consultations with staff of the OSC and have been in operation without problems for more than six years. In these circumstances **no** compensation fund coverage attaches to the non-cash assets held at the trust company. There are far more assets held at the trust companies under these arrangements than under the questioned omnibus arrangements.[12] Given the only material difference between this structure and the general

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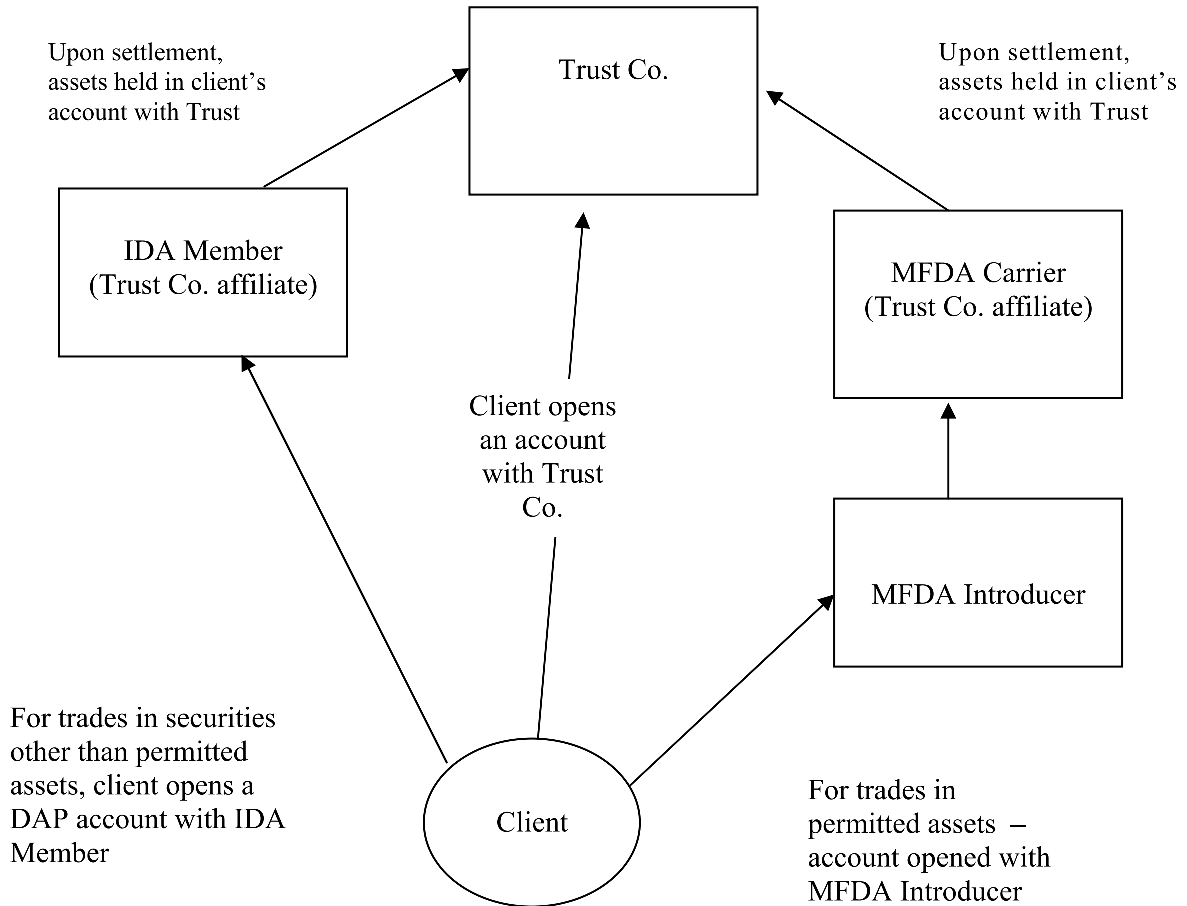
[11] There doesn't appear to be any requirement that an entity performing custodial activities be licensed in any fashion under financial sector legislation. While most are banks and trust companies, the entity holding the largest value of securities is The Canadian Deposit for Securities, which is neither a dealer, nor a financial institution. The Commission has recognized it as a clearing agency, but it was not required to be so recognized by Ontario law.

[12] The MFDA estimates that there is about $1 billion in assets held for mutual fund dealer clients in omnibus arrangements, while $24 billion worth of assets are held in registered accounts at the two trust companies using this structure.

omnibus arrangements is the entity that holds the prohibited securities; the differential treatment provides a competitive disadvantage to the dealers wanting to offer omnibus arrangements that does not seem to be justified from an investor protection policy perspective.

For example, certain MFDA Members use the facilities of intermediaries to allow for consolidated RRSP accounts. These intermediaries provide "carrying dealer" services to MFDA Members, as they do not have the necessary resources to offer their own registered plans. The intermediary structure can be diagrammed as follows:



In this arrangement, a client has a primary relationship with a mutual fund salesperson/dealer. The client opens a dealer account at the MFDA member and an account with the trust company. Mutual fund trades may be placed and/or settled through either the trust company or the mutual fund dealer.

Where a client wants to trade in a security the mutual fund dealer is unable to sell, the client is referred to an IDA Member affiliated with the trust company. The IDA Member opens a delivery against payment account for the client and upon settlement, delivers the assets to the trust company.

Summary

None of the issues raised in connection with joint arrangements are new. The issues about trading beyond licensing restrictions, client confusion and identification of client assets in the event of an insolvency arise even in the full service dealer environment. The Committee is generally of the view that these problems may continue to be addressed adequately by a combination of disclosure to the clients, training of sales representatives, internal policies and procedures to limit the opportunities for improper actions, supervision at the dealer level to detect breaches and oversight by the relevant SRO and securities commissions.

The Committee has identified one model that we believe completely addresses the issues raised by the OSC staff with certain types of arrangements and another that responds to client needs but will require supplemental disclosure and procedures to address those issues. The service provider model deals with the situation where the trading activities for the mutual fund dealer's clients are limited to permitted assets, but the mutual fund dealer cannot hold/process the trades in certain classes of these securities. The second model applies to registered retirement savings plans (RRSPs) where the client wishes to hold both permitted assets and prohibited assets in a single registered plan.

The Committee believes that there may be acceptable structures in addition to those identified here that should be permitted, provided that they are properly structured. In particular:

- Once the MFDA establishes its own compensation plan that would provide equivalent coverage to CIPF, the "new and improved" omnibus account structure should be permitted provided the Commission agrees that the role filled by the mutual fund dealer is not automatically characterized as an act in furtherance of trades beyond the limitations on the dealer's registration category; and
- The introducer/carrier model should be made available for permitted assets once the MFDA becomes a participating institution in CIPF.

MEMBER REGULATION

notice

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MR0291

May 21, 2004

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

Consolidation of Back-Office Operations of a Member firm and its Affiliate

The purpose of this Notice is to provide guidance as to permissible back office activities between an IDA member and any affiliated Canadian financial institution. Common staff will be able to handle securities clearance, settlement, maintenance of records and/or other operational functions on behalf of both the IDA member and its affiliate(s).

This arrangement is exempted under the general provisions of IDA Bylaw 35.1(d), for introducing/carrying rules provided the requirements outlined in this Notice are met.

Definition

As defined in IDA Bylaw 35.1(a)(iii), **Canadian financial institution** means a Schedule 1 or Schedule II Bank pursuant to the *Bank Act* (Canada), an insurance company governed by federal or provincial insurance legislation and a loan or trust company governed by federal or provincial loan and trust company legislation.

Regulatory Issue

IDA Regulations require member firms to maintain an adequate system of books and records. These records must be separate and distinct so that customer assets are not co-mingled with another legal entity's customer assets unless the requirements of an introducing/carrying broker arrangement prescribed by By-law 35 are met.

An adequate system of books and records includes the production of a general ledger, stock record and trial balance of the member firm is "self-balancing". In other words, the accounting records of the member firm and its customer accounts are separate and distinct from any extraneous balances of customer accounts belonging to another entity.

As an example, the IDA requires a separate EDP (either external service provider or in-house proprietary system) company code be maintained for the books and records for each member firm. No two or more separate legal entities are permitted to share a **common EDP company code** unless they are SRO members for the purpose of introducing/carrying arrangements, or the SRO members are related and cross-guaranteed under the provisions of By-law 6.6. The co-mingling of customer assets of a non-SRO member firm on the same EDP company code as the member firm is strictly prohibited. This serves to protect the interests of the investing public in the event any SRO member becomes insolvent by separately identifying customer assets of the SRO member firm for purposes of CIPF insurance coverage.

Aside from the existing introducing/carrying arrangement rules, the IDA has previously taken a regulatory position that when a member firm wants to share a common EDP code with an affiliate, the EDP system must be "hard coded" to clearly identify customer accounts of the member firm and its affiliate. Specifically, the EDP system must be capable of producing self-balancing accounting records such as trial balance and stock records, and prevent any movement of customer monies or securities by journal entry between customer accounts of the member firm and its affiliate. In addition, the custody of monies and securities in the accounts of the affiliate must be maintained separately under the control and legal name of the member and its affiliate.

Requirements for Permitting Back-office Consolidation

Member firms have asked the IDA to establish the requirements for the consolidation or integration of back-office operations between a SRO member firm and its affiliate(s) as contemplated by By-law 35.1(d**). This type of arrangement involves sharing the IDA member firm's EDP service bureau company code (e.g., ISM, ADP and Dataphile) with an affiliate whereby there is no commingling of customer assets under administration between the member and its affiliate. This condition is achieved by operating separate bank and security custody accounts in the name and control of the IDA member and its affiliate.**

Back office consolidation allows the for the creation of separate customer account ranges on a common EDP company code system of books and records with offsetting "control accounts" to manage and separately track transactions between customers of the IDA member from customers of its affiliate.

The processing of customer transactions under the same company EDP code platform requires that critical preventive and detective internal controls be implemented to distinguish customer trading activity between the member and its affiliate and identify errors or irregularities in processing of customer transactions so that corrective accounting entries are made. This involves maintaining operational "control accounts" for the affiliate's customer transaction flow that is balanced and reconciled next day against customer trades, customer monies and security positions held in bank and custody accounts in the name and control of the affiliate.

Criteria for Obtaining Regulatory Approval

The Member firm must submit a written request for review of the arrangement to the IDA. The following is the criteria upon which IDA approval will be based:

1. There must be common ownership (more than 50% controlling interest) of the member and its affiliated Canadian financial institution:

2. The affiliate must be a Canadian financial institution such as a bank, insurance, loan and trust company. This excludes mutual fund dealers that are members of the Mutual Fund Dealers Association of Canada until further notice.

3. The member and its affiliate must share a common EDP company code to process customer transactions through a common back-office. A service or management agreement must be in place to identify the specific operational and functional responsibilities of back-office staff.

4. The customers of affiliates must be separately identified as a range of accounts on the EDP system of books and records of the IDA member firm. The system of books and records must be capable of producing separate customer balances and stock record positions for the range of accounts of the affiliate that are offset on the records of the IDA member firm as control accounts. Such control accounts must be reconciled daily against customer trades, bank balances and security custody positions held in the name and control of the affiliate.

5. A written contractual agreement must be in place between the Member firm and its affiliate setting out the terms and conditions for the services provided.

6. Contract arrangements must be in place with the Member firm and their EDP service provider to ensure independent third party access to books and records maintained by the member firm in respect to customer accounts of the affiliate, as would a trustee in the event of insolvency by the member firm.

7. Written policies and procedures must be in place that identifies the operation of control accounts, reconciliations of bank and custody accounts under the name and control of the member and its affiliate. This includes controls to review and approve all accounting journal entries by a designated senior management personnel between account ranges of the member and its affiliate sharing the same company code before processing.

8. Separate company customer statements must be generated for the customer accounts of the member and its affiliate. The consolidation of the portfolio of customer assets of both the IDA member and its affiliate is in addition to, but not in place of, the monthly statements required by Regulation 200.1 for the IDA member firm and the governing rules for the affiliate entity.

Internal and External Audit Requirements

Documented policies and procedures describing the transaction flow and controls must be developed and reviewed by the internal audit department and/or external auditors of the member firm as to whether they meet the specified internal control objective of generating separate customer trial balance and stock record positions, and separate custody and control of customer monies and securities between the member and its affiliate(s).

An annual audit report on the Control Objectives and Procedures is required in conjunction with the filing of the audited regulatory financial statements of the member firm. Such audit report will be prepared in adherence with CICA Handbook Section 5900.

Appendix B
Back-Office Service Provider Model

Regulatory Issues Raised During Review	Response
Mutual fund dealer registered representative selling outside registration	Not a special concern as arrangements limited to dealing with permitted securities only.
Regulatory access (books and records, premises, personnel etc.) to member of another SRO	See the terms and conditions in the IDA Notice. Both dealers would have to consent to access by the other dealer's SRO as condition of approval of the arrangement. In addition, both dealers would have to agree to provide any information etc. reasonably required by regulators (or others, such as the external auditor of mutual fund dealer or trustee in bankruptcy) and consent in advance to access by these persons. Any residual questions about the ability of the SROs to share information should be addressed by the IDA and MFDA entering into an MOU.
Difficulty of supervising mutual fund dealer registered representatives when records kept elsewhere	Trade tickets, etc. used to initiate trades in permitted assets would be generated at the mutual fund dealer, so the mutual fund dealer will have the necessary information to do pre-trade supervision. For post-trade supervision via review of trading reports, the services provided by the investment dealer must include giving the mutual fund dealer the necessary reports to allow for effective supervision of its registered representatives. Note: the supervision situation is more straightforward here than for Type 1 introducing/carrying broker arrangements where supervision responsibilities are shared between the introducer and carrier.
Difficulty of separating assets and records on insolvency of one of the dealers	The Notice requires clearly separate books and records for each dealer involved. The prohibition on commingling of client assets should protect clients if one of the dealers becomes insolvent. If the service provider follows the procedures required by the Notice and the general record keeping requirements of the SROs, the insolvency of either dealer should not be any more complicated than usual. In fact, the failure of a mutual fund dealer using a back-office service provider may be easier to manage than the failure of many other mutual fund dealers as the systems are likely to be more sophisticated at the investment dealer service provider. Further, the service provider is likely to be still in business and so available to provide information and support to the bankruptcy trustee and the regulators.
Client confusion	These arrangements would be limited to permitted securities only and the role of investment dealer service provider is not visible to investor, so there should be no client confusion about who they are dealing with,

Regulatory Issues Raised During Review	**Response**
	what may be traded, or what insurance or compensation fund coverage applies. There is no general requirement that mutual fund dealers must explain either the limitations on their trading authority or the compensation fund coverage that does or does not apply. From the clients' perspective there is no visible difference between a mutual fund dealer using one of these arrangements and all other mutual fund dealers, so there would be no reason to impose any greater disclosure requirements.
No CIPF coverage	Same treatment as all other mutual fund dealers; all clients of mutual fund dealers covered in the same way and to the full extent that is required by law or MFDA requirement. See above – the arrangement would give a client no particular reason to assume that the account was covered by CIPF.
Liability for errors and failures unclear	No different liabilities than for accounts held at other mutual fund dealers. The mutual fund dealer remains responsible to clients and regulators for all errors and failures relating to the mutual fund dealer's accounts or arising because of the actions of its registered representatives. Tasks are transferred to the service provider, but the ultimate responsibility for fulfilment of all duties is not shifted. Mandatory contract between two dealers would set out respective responsibilities of the dealers to each other.

Appendix C
Two Account, One Plan RRSP Model

Regulatory Issues Raised During Review	Response
Mutual fund dealer registered representative selling outside registration/ facilitation of non-compliance	Mutual fund dealer registered representative is only selling/dealing with permitted assets. There should be clear policies and procedures at the mutual fund dealer setting out what the mutual fund dealer registered representative may do and limiting the mutual fund dealer registered representative's ability to initiate trades or otherwise participate in the investment decisions in prohibited securities at the investment dealer account. Because the model contemplates two accounts at two different dealers, the account opening agreement for the plan should include clear disclosure to clients regarding respective roles of each dealer and the registered representatives involved and of the limitations on the role/activities of the mutual fund dealer. The compensation of the mutual fund dealer registered representative should not include credit for on-going activity in the investment dealer account. This should reduce any incentive to take actions for which the registered representative is not licensed.
Regulatory access (books and records, premises, personnel etc.) to member of another SRO	Access should not be a special issue for these sorts of accounts, as each dealer should be keeping its own records for the activity in its particular accounts. However, to facilitate full supervision by SROs, it would be prudent to require consent of the dealers to cross-access by the other SRO as a condition of approval of the arrangement. An MOU between IDA and MFDA regarding sharing of information and assistance to the other SRO on investigations also would be helpful.
Difficulty of supervising mutual fund dealer registered representatives when records kept elsewhere	This should not be a special issue as the records used for supervision of trading activities should be at the relevant dealer.
Difficulty of separating assets and records on insolvency of one of the dealers	No special issue as each dealer's records should be separate, as should the client assets. If the trust company acts as the custodian, the client assets should not be affected by the failure of either dealer.
Administration of registered plans does not comply with OP 4.3	Neither the mutual fund dealer nor the trust company is expressly subject to the terms of OP 4.3. The trust company's responsibilities and liabilities are determined by the Income Tax Act, trust law and the terms of the declaration of trust. If the trust company is carrying out all non-trading activities for the plan, OP 4.3 (or NI 33-101) is not relevant. Where the mutual fund dealer has an active role in the operation of the self-directed RRSP, there is a gap in the rules that govern its activities. This gap could be filled by:

Regulatory Issues Raised During Review	Response
	• The CSA finalizing NI 33-101; or • Conditioning the SRO approval of the arrangement on the dealers agreeing to comply with the highest relevant standard that either dealer is subject to in operating the accounts.
Client confusion	The account documentation given to the client when establishing the account should contain clear disclosure of the respective roles and responsibilities of each dealer involved, including a description on the limitations on the role of the mutual fund dealer. Clients should also be provided with guidance on how the various account and plan statement fit together.
No CIPF coverage for mutual fund dealer clients	If the permitted assets are held at the mutual fund dealer, then this is the same treatment as that afforded to all clients of mutual fund dealers. All clients are covered in the same way and to the full extent that is required by the law or MFDA rules. If the trust company acts as the custodian, the client assets should not be affected by the failure of either dealer. If the trust company fails, the only applicable compensation scheme is Canada Deposit Insurance Corporation coverage for Canadian dollar deposits.
Liability for errors and failures unclear	No special issue. As in all RRSP arrangements, the taxation authorities require the trust company to be ultimately liable to the plan holders under the declaration of trust. Respective liabilities of dealers to the client would be set out in the account opening agreement.
No single registrant responsible for giving advice on the whole account	This structure is consistent with the current structure of the industry and the law. There is no current legal requirement that all securities owned by a client be held in one account, at one dealer or in an account for which advice is given. Imposing such a rule would interfere with the client's freedom to contract and be inconsistent with the terms covering the discount broker category.
Informal arrangements	These types of arrangements have to be established by formal declaration of trust and other contractual arrangements between the parties involved, so the issue of informal arrangements should not be an issue. To ensure the specific concerns regarding respective activities of the dealers involved are addressed, the SRO rules should require the approval of the relevant SRO. This would also allow the SRO to factor the existence of an arrangement into the examination plan for that dealer.

Appendix D.
Omnibus Arrangements

Specific Terms and Conditions for Omnibus Arrangements:

The structure builds on the existing omnibus arrangements with specific terms and conditions (client disclosure, internal controls, reporting, compensation arrangements, etc.) prescribed to address the concerns expressed by regulators. Each of these arrangements would be subject to prior approval of the SROs and the SROs would perform specific procedures on compliance examinations of the participating dealers designed to ensure the terms and conditions continue to be met.

- Client disclosure (initial and on-going)
    - As part of the account opening process, the client would be provided with specifics of the roles and responsibilities of each dealer involved – particularly the limitations on what the mutual fund dealer and mutual fund dealer registered representative can do. (The clients should acknowledge their receipt of the disclosure in the account agreement or on separate document.)
    - If the securities of the client are held in an omnibus account for the mutual fund dealer after settlement, rather than in an individual client account, the client should also be told about the compensation fund implications, if any.
    - There should be periodic reminders from the mutual fund dealer (on the clients' account statements or otherwise) to the clients of limitations on what mutual fund dealer may do when one of these arrangements is in place.
    - There should be clear terms in contracts with clients about respective responsibilities and liabilities to the client.

- Internal controls
    - Instructions for trades or any other transactions involving the investment dealer account cannot come from mutual fund dealer or mutual fund dealer registered representative
    - Trades in prohibited assets should not appear on mutual fund dealer account statements. If a portfolio summary statement is prepared aggregating all securities held in both accounts, the summary should make it clear which dealer holds which securities. (See the requirements in the MFDA rules regarding the use of portfolio statements.)
    - The client should initiate transfers of cash from the client's account at the mutual fund dealer to settle trades at the investment dealer, not the mutual fund dealer or its representatives.

- Location of assets:
    - All prohibited assets would be held at the investment dealer.

- Compensation arrangements
    - Referral fees subject to SRO rules and requirements that all fees be disclosed to clients and the client consents to the payments
    - Mutual fund dealer registered representative compensation should not be linked in any way to the assets held in the account at the investment dealer.

- Supervision of trading
    - The investment dealer must send the mutual fund dealer compliance personnel copies of trade reports (daily/weekly/monthly), new account activity reports and concentration reports in connected with the related investment dealer accounts so that the mutual fund dealer has full information to identify improper actions by the mutual fund dealer's registered representatives. The mutual fund dealer should be looking for patterns such as several clients of the same mutual fund dealer registered representative carrying out similar transactions at the investment dealer. (Note: the client would have to give specific consent to this sharing of information between the dealers.)
    - If a significant percentage of assets in a client account are prohibited securities, account probably should be moved in total to a regular account at the investment dealer.

- Other
    - The mutual fund dealer's registered representatives should be given training on what they can and cannot do; this information should also be included in the sales manuals provided to registered representatives.
        - There should be guidance addressing activities such as joint meetings with the clients and the investment dealer representatives.
        - The mutual fund dealer registered representatives should be periodically reminded regarding these limitations on their activities.
    - The mutual fund dealer should review the personal trading by its registered representatives – whether at mutual fund dealer or through another dealer. To do this, the dealer should require its registered representatives have duplicate client statements sent to their mutual fund dealer compliance department. (Review of these reports in conjunction with a review of client trading at the investment dealer may highlight trading activities indicating improper actions by the mutual fund dealer registered representative.)

Regulatory Issues Raised During Review	**Response**
Mutual fund dealer registered representative selling outside registration/ facilitation of non-compliance	Mutual fund dealer registered representative only selling/dealing with permitted assets. There should be appropriate policies and procedures and internal controls within the dealers to prevent breaches of limitations on mutual fund dealer and mutual fund dealer registered representative licences, including • Clear guidance & training within mutual fund dealer explaining what mutual fund dealer registered representative may do and limiting the mutual fund dealer registered representative's ability to initiate trades at the investment dealer account. • Clear policies and procedures at the investment dealer limiting the ability to accept trading instructions from mutual fund dealer personnel. • Account statements of each dealer contain only those assets

Regulatory Issues Raised During Review	Response
	trade through or held by that dealer for the client. Any portfolio summaries provided to clients by the mutual fund dealer must adhere to applicable MFDA requirements. Sales compliance audits of mutual fund dealer by MFDA should include specific module examining arrangements. Clients should be given express disclosure regarding respective roles of dealers and registered representatives involved and the limitations on the role of the mutual fund dealer. Compensation of mutual fund dealer registered representative should not include credit for on-going activity in investment dealer account, which should reduce the incentive for acting outside the mutual fund dealer registered representative's registration. Any referral arrangements must comply with mutual fund dealer rules.
Regulatory access (books and records, premises, personnel etc.) to member of another SRO	Access should not be a special issue, as each dealer should be keeping its own records for the activity in its particular accounts. However, it might be prudent to provide for cross-access to the other SRO and for an MOU between IDA and MFDA to ensure full access is available.
Difficulty of supervising mutual fund dealer registered representatives when records kept elsewhere	No special issue as the records used for supervision of trading activities should be at the relevant dealer. There may be some need to share information about the trading taking place in the client account at the investment dealer with the mutual fund dealer to provide a further check that no inappropriate advice is being given. All such information sharing would be provided for in the agreement between the dealers and would have to comply with privacy legislation (i.e. express client consent required).
Difficulty of separating assets and records on insolvency of one of the dealers	No different situation than for any other arrangement where the investment dealer holds assets for other dealers. Each dealer's records should be separate. The client assets of the mutual fund dealer held at the investment dealer should all be in the omnibus account for that mutual fund dealer.
Client confusion	The account documentation given to the client when establishing the account should contain clear disclosure of the respective roles and responsibilities of each dealer involved, including the limitations on the role that the mutual fund dealer may play, and the compensation fund coverage issue for the securities at the investment dealer – if relevant. The client should be reminded of these facts periodically.
No CIPF coverage for assets of clients held at investment dealer	Ceases to be an issue if MFDA proceeds with decision to establish investor compensation fund with equivalent coverage as CIPF (or eventually joins CIPF as a participating institution)
Liability for errors and failures unclear	No special issue. Client disclosure on account opening should make respective responsibilities & liabilities of both dealers clear.
Lacking single registrant responsible	This structure is consistent with the current structure of the industry and the law. There would be two accounts each with their own

Regulatory Issues Raised During Review	Response
for giving advice on whole account	appropriately qualified registered representative to advise the client. There is no current legal requirement that all securities owned by a client be held in one account, at one dealer or in an account for which advice is given. Imposing such a rule would interfere with the client's right to contract and would require elimination of the discount broker registration category.
Informal arrangements	SROs should require: • Contract between investment dealer and mutual fund dealer setting out mechanisms for operating the accounts, the provision of information between the dealers etc. • Prior consent of the relevant SRO so that the SRO will know to look at the arrangements on an examination.

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