



MEMBER REGULATION



notice

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MR0481

July 13, 2007

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Off-book Transactions

Compliance Interpretation Bulletins C-93 dated February 15, 1996, C-93B dated February 26, 1996, and C-106 dated August 28, 1996, described IDA requirements regarding transactions in mutual funds in which Member firms arranged trades in mutual fund units between their clients and fund companies.

Prior to the interpretation bulletins, some Members had conducted these transactions “off-book”. This terminology was used to describe the purchase of fund shares where payments were passed through the Member or sent directly from the client to the mutual fund company with no resulting transaction being recorded on the Member’s books or in the customer’s account at the Member.

The previously issued bulletins referred only to mutual fund transactions because the practice of conducting such transactions off-book was gaining momentum as way of doing mutual fund business. However, the underlying principle outlined in the bulletins for mutual fund transactions applies consistently across all securities transactions arranged through a Member. Specifically, all securities transactions in which a Member acts must be recorded on the Member’s books and in the client’s account.

The purpose of this bulletin is to remind members of the Association books and record requirements for securities transactions based on general principles. It also provides further guidance on how to differentiate a transaction that involves the referral of a client to a third party service provider which may not require the resulting securities transaction to be recorded by the member firm.

The IDA defines broadly what constitutes acting in a customer transaction, including:

- making a recommendation to the client, whether the transaction is the RR's idea or the client's
- bringing the client's attention to a possible transaction
- arranging the transaction in any way.

A Member involved in any of these activities must record the trade on its books. Any transaction for which a Member receives any form of compensation, whether called a commission, a finder's fee or anything else, will be considered a trade in which the Member has acted. If a fee is not paid, the Member may still be involved in a trade by virtue of the advice given or arrangements made to facilitate the trade. All compensation paid for securities-related transactions must be paid directly to the Member and not to an individual Registered Representative. There is no exception for transactions for which exemptions from prospectus or registration requirements are available.

Books and Records

An off-book transaction is an incomplete record where any part of the trade cycle (execution to settlement) by-passes the back-office brokerage accounting system of the member firm and requires manual processes to record it on book. This commonly occurs when funds are paid directly from the client to the third party, as may occur in client-name mutual fund purchases, non-brokered private placements or "trade give-ups" where the client pre-arranges to settle directly with a third party broker/dealer.

Although customer monies are not handled by the member or security positions delivered or received through the member in the settlement phase of the trade, it is still necessary for the firm to record these trades on its books. This may require the use of "control accounts" representing the third party in such transactions to offset and balance journal entries recorded in the customer account. In addition, a trade confirmation and month-end customer statement must be sent to the customer providing a complete audit trail of the trade cycle.

Documented internal control policies and procedures must also be in place at member firms to prevent off-book trades going undetected and to manually compensate by capturing these transactions by journal entry in the customer account. To evidence accuracy and completeness of the manually-recorded transactions, and reconcile its control accounts, the member must obtain customer transaction details from the third party. This reconciliation must be reviewed and approved by a designated person.

Referral Arrangements

The Association has been involved in a working group on referral arrangements that resulted in sections 6.11 to 6.15 of Proposed National Instrument 31-103 – Registration Requirements.

One of the issues dealt with by the working group, as described in Section 6.10 of the Draft Companion Policy 31-103CP, is the structuring of client transactions as referral arrangements in which a dealer sends a client to a product manufacturer to purchase specific securities. Such transactions can occur where the manufacturer is an adviser or fund manager that manages funds sold by private placement using exemptions from dealer registration available under securities legislation. In other cases dealers have sent clients to issuers for private placements.

It is the IDA's position that if the client is sent to an adviser, other dealer or issuer to purchase a specific security, the Member is not entering into a referral arrangement. The Member is effecting a trade that should be done on-book. The same may be true where the full details of the specific security are not determined, but the client will be purchasing one of a series of similar securities.

A referral occurs when the client is sent to another party for a service. If the other party is an adviser or dealer, the adviser or dealer will conduct its own know-your-client assessment and determine what is appropriate for the client, with no further involvement of the referring dealer. The investments may involve funds managed by the adviser, but the purchase of such funds is not the purpose of the referral. It is incorrect to characterize a customer transaction as a referral arrangement where the other party sells only one security, for example, an issuer selling a private placement.

Compliance Interpretation Bulletins C-93 and C-106 [continue to apply and](#) are available on the IDA's Regulatory Resources web site:

<http://ida.knotia.ca/Knowledge/Browse/BrowseTOC.cfm?kType=445&initOpenParentList=200706341%2C1%2C2&nc=16275166297020070608>