



Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

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RE: Mutual Fund Dealers Association of Canada Proposed Amendments to MFDA Rule 2.3.1(b) (Discretionary Trading)

FAIR Canada is pleased to offer comments to the Mutual Fund Dealers Association of Canada (MFDA) and British Columbia Securities Commission (BCSC) regarding proposed amendments to MFDA Rule 2.3.1(b) and consequential proposed amendments to MFDA Rule 2.2.5 as per the MFDA bulletin #0782-P published April 4, 2019.¹

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1.1 FAIR Canada is concerned with the adequacy of investor protections contained in the proposals to allow mutual fund dealers to carry out discretionary trading in clients accounts in mutual fund securities that are part of a model portfolio offered by the mutual fund dealer.

1.2 While the MFDA bulletin contains a description of “model portfolios”, there is no such definition contained in the MFDA Rules and as such the limited discretionary

¹ <http://mfd.ca/wp-content/uploads/PropAmend231b-2.pdf>

trading authority being proposed is inadequately limited by reference to a “mutual fund model portfolio offered by the Member”. We strongly recommend that the term “mutual fund model portfolio” be defined in the MFDA Rules in order to ensure that dealers and their representatives do not engage in discretionary trading in client accounts other than in the restricted circumstances of making fund substitutions and changes to portfolio asset allocations in client accounts invested in dealer administered model portfolio programs, as described in the MFDA bulletin#0782-P.

1.3 Similarly, FAIR Canada recommends that there needs to be greater certainty around the limited circumstances when, under the proposed amendments, the exception to the prohibition on discretionary trading under MFDA Rule 2.3.1(b) is permitted. While the MFDA bulletin states that the exception would only be permitted “within pre-established parameters of the mutual fund model portfolio” the wording of the proposed amendments in MFDA Rule 2.3.1(b.1) does not specify that the exception is limited to pre-established parameters of the mutual fund model portfolio. The proposed amendment to MFDA Rule 2.2.5 Relationship Disclosure refers to written disclosure to the client at the time a new account is opened of “a description of the extent of the discretionary authority being exercised”. Given the the inherent limitation on the effectiveness of disclosure statements that are contained in the extensive documentation that clients are given by dealers when opening an account, we recommend that the MFDA Rule 2.2.5 wording be clarified to require explicit disclosure of the limited parameters model portfolio discretionary trading that MFDA Rule 2.3.1(b.1) allows, i.e., in restricted circumstances for making necessary fund substitutions and changes to portfolio asset allocations in accordance with the mutual fund model portfolio parameters that have been thoroughly explained to the client by the MFDA Dealer representative to the client and agreed to by the client.

1.4 FAIR Canada is supportive of the requirement in the proposals that any MFDA dealer and any MFDA dealer personnel that are permitted to engage in the proposed limited discretionary trading for clients who have invested in a mutual fund model portfolio program must be registered under securities legislation to provide restricted discretionary portfolio management services. This registration will impose a fiduciary duty to act with care, honesty and good faith and to put the clients interests first rather than allowing factors such as imbedded compensation to the dealer and/or the dealer’s representative to influence the investment and trading decisions in the clients accounts.

1.5 FAIR Canada recommends that the MFDA establish specific supervision requirements to be addressed by any MFDA dealer and imposed on any MFDA dealer personnel who are become registered under securities legislation to provide discretionary portfolio management services for the limited purposes of proposed MFDA Rule 2.3.1(b.1). Supervision requirements should include appropriate, written discretionary portfolio management services supervision procedures, designated supervisory personnel and specific account activity reviews for any client account in which discretionary portfolio management services are permitted. Such requirements would be consistent with the requirements of Investment Industry Regulatory Organization of Canada (IIROC)

Rules 1300.3, 1300.4, 1300.5, 1300.6, 1300.7, 1300.8, and 1300.15², and 2500 part VII³ dealing with discretionary managed accounts. We note that IIROC Rule 1300.7(a)(i) and 2900 only were referenced in the MFDA bulletin #0782-P as the comparable regulations considered by the MFDA in developing the proposed amendments to the MFDA Rule 2.3.1 and consequential amendments to MFDA Rule 2.2.5. We believe that a more comprehensive review of comparable regulations that includes requirements for appropriate supervision procedures for discretionary managed account services should be undertaken.

1.6 FAIR Canada would also recommend the MFDA consider how fees are to be regulated for discretionary managed account services for clients who invest in a dealer's mutual fund model portfolio services. Fees for similar services at IIROC dealers are regulated by specific IIROC Rule requirements. See IIROC Rules 1300.16, 1300.17, and 1300.21.

1.7 FAIR Canada notes that according to the MFDA bulletin #0782-P proposed amendments to MFDA rule 2.3.1, reference is made to OSC Staff Notice 81-708 - Model Portfolios of Mutual Funds (published May, 2006)⁴ which sets out guidance regarding disclosure expectations for mutual fund dealers seeking exemptions in order to carry out rebalancing changes model portfolios of mutual funds, including changes within predetermined parameters as well as replacing existing funds with new funds using the dealers own discretion. The OSC Staff description of account opening disclosure requirements expected to be addressed should be considered closely by the MFDA and incorporated into the consequential amendments to MFDA Rule 2.2.5 Relationship Disclosure or other required client disclosures as appropriate. These include:

- clear description of the model portfolio product
- clear description of the number of model portfolios, including how many model portfolios are offered, the types of portfolios offered (such as growth, income or balanced) and whether the the portfolios consist of funds of the fund manager
- clear explanation of how the model portfolios are designed and who is involved in designing them
- clear explanation of how investment ranges are established, how re-balancing occurs, and whether new funds may be substituted in the model portfolios
- the minimum amount required to invest in the model portfolio product

² IIROC Rule 1300 Supervision of Accounts, online: https://www.iiroc.ca/Rulebook/MemberRules/Rule01300_en.pdf

³ IIROC Rule 2500 Minimum Standards For Retail Customer Account Supervision, online: https://www.iiroc.ca/Rulebook/MemberRules/Rule02500_en.pdf

⁴ OSC Staff Notice 81-708 Model Portfolios of Mutual Funds, online: https://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20060526_81-708_modelportfolios.pdf

- the fees associated with the model portfolio product, including the basis on which they are charged and how they are paid
- clear description of reinvestments of distributions
- where to get more information and how to sign up for the model portfolio product
- clear description of what discretionary authority is exercised, how it is exercised and by which entity
- clear description of when client consent is required for an action
- clear description of the entity or entities legally responsible to the investor for any liabilities concerning the model portfolio product

We thank you for the opportunity to provide our comments and views in this response. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Douglas Walker at 647-256-6690 / douglas.walker@faircanada.ca

Sincerely,



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