

A.S.C. Notice 19A

Distribution of Mutual Funds by Financial Institutions

Principles of Regulation

Preamble

Prior to 1988 financial institutions ("FIs") were able to distribute certain mutual fund securities through their branch networks on a largely unregulated basis. In some cases the FIs were exempt from both registration and prospectus requirements while in other cases prospectus requirements were applied and registration requirements were minimal. Regulatory changes initiated in 1987 had the effect of subjecting the branch distribution of mutual fund securities by FIs to the full scope of securities regulation. When these changes were first implemented in 1988 it was apparent that the provincial and territorial securities regulators were implementing rules which were not consistent on a national basis. It was also apparent that this lack of regulatory consistency would, if continued, have a negative impact on the efficient delivery of financial products and services to the public.

In May of 1988 the Canadian Securities Administrators ("CSA") formed a subcommittee ("Subcommittee") to review the approaches being followed in the provinces and territories regarding the regulation of mutual fund distribution by FIs. The Subcommittee has met on three occasions and its members have discussed this issue with representatives of the Canadian Bankers' Association ("CBA"), The Trust Companies Association of Canada ("TCA"), the Investment Funds Institute of Canada ("TFIC"), self-regulatory organizations and officials of FIs.

The Subcommittee's objective has been to develop a basic regulatory approach which will be consistently applied in all provinces and territories. This objective has, for the most part, been realized. This notice sets out those areas where, unless otherwise noted, the provincial and territorial securities commission ("Commissions") were able to arrive at a consensus. Any registration requirements not expressly dealt with in this notice have been left to be dealt with as prescribed by existing provincial or territorial regulation.

The Subcommittee considered whether these Principles of Regulation should be implemented as a National Policy Statement. In order to ensure timely implementation of the rules contained in this notice it was decided that each provincial or territorial securities commission would adopt the principles of Regulation in its own fashion (eg. through the exercise of regulatory discretion). The CSA also decided that the subcommittee should continue its work with a view to developing the Principles of Regulation into a National Policy statement as soon as possible.

In the course of the Subcommittee's deliberations it became apparent that the new rules allowing FIs to participate more actively in the securities industry raise a number of regulatory concerns and issues for

which no clear answers or guidelines exist. Accordingly, in areas of uncertainty the Commissions have adopted a cautious approach with a view to revisiting these issues as experience dictates. While any particular issue could be reviewed in a shorter time frame, the Commissions are of the view that the approaches set out in the National Policy Statement which is developed from the Principles of Regulation should be reviewed in no later than three years time to assess whether they adequately serve legitimate regulatory and business concerns.

The procedures described below apply only to the distribution of mutual fund securities through the premises of the branch network of a FI where such activity is otherwise permitted by the legislation to which the FI is subject. The Dealer (as defined in paragraph 1) may sell mutual fund securities from locations other than the branches of the FI provided that all conditions of registration applicable to the proposed activity have been satisfied. For the purposes of this notice a FI means any financial institution carrying on business through a branch office network including banks, trust companies, loan companies, insurance companies, treasury branches, credit unions and caisse populaires. In Quebec the Confederation des caisses populaires et d'economie Desjardins du Quebec will be considered to be a financial institution and each individual caisse populaire will be considered to be branch of the Confederation.

The province of Manitoba participated in some of the Subcommittee's discussions but has refrained from adopting the Principles of Regulation at this time. The present interim position in Manitoba is that the distribution of FI sponsored mutual funds through the FIs branch system is either a statutorily exempt activity or is subject to a regulatory scheme which may or may not require the licensing of individual salespersons, depending on the institution and the circumstances of each case. Interested parties should contact the Manitoba Commission directly to ascertain what requirements might apply.

Regulation

1. Control of registrant. A FI may distribute mutual fund securities in its branches only through a corporation ("Dealer") which it controls directly or indirectly or with which it is affiliated. The Dealer must be registered as a dealer in each province or territory where the mutual fund securities are distributed and must satisfy normal registration requirements except where modified by this notice.
2. Registration of employees. Individuals involved in the sale of mutual fund securities must be registered as salespersons and must satisfy normal registration requirements except where modified by this notice.
3. Dual employment. Employees of a FI who are engaged in financial services activities may also become registered as salespersons of the Dealer for the purpose of selling mutual fund securities provided that such dual employment is permitted by the legislation to which the FI is subject.
4. Conflicts of Interest. The Subcommittee gave close attention to the question of the conflicts of

interest that can arise as a result of dual employment and the sale of mutual fund securities in a branch of a FI. For example, a FI employee who receives compensation based directly on the sale of mutual fund securities but not on the sale of other products may be inclined to sell mutual fund securities even if that is not the best alternative for a particular client. This situation would be exacerbated if the FI employee was also able to make a loan to the client to finance the purchase of the securities. Even when the dually employed person is paid on a salary only basis a conflict of interest concern may arise if the dually employed person can both sell mutual fund securities to a client and lend that client the funds to pay for that purchase. In these situations the potential exists for excessive lending to encourage mutual fund sales.

These concerns could have been dealt with by restricting the ability of the Dealer to compensate its salespersons by any manner based directly on sales. Similarly, other concerns could have been dealt with by restricting the ability of the dually employed person to make loans to mutual fund clients in respect of their purchases. The Commissions concluded that such an approach, if applied in all circumstances, would be overly restrictive in view of the business and lending controls followed by most FIs.

To address these concerns the Dealer must adopt and implement supervisory rules to prevent conflicts of interest arising due to the dual employment of a registered salesperson. These procedures must address potential conflicts and must be filed with and approved by the relevant provincial and territorial securities administrators unless such procedures provide that, inter alia:

- (a) dually-employed salespersons are paid on a salary only basis (any form of compensation linked directly to the activity of selling mutual funds, including bonus payments, would require conflict procedures to be filed with and approved by the relevant Commissions); and either
 - (b) any loan made by a dually-employed salesperson for the purpose of financing the purchase of mutual fund securities sold by that salesperson is approved by a senior lending officer of the FI; or
 - (c) the dually-employed salesperson is not permitted to make loans to finance the purchase of mutual fund securities sold by that salesperson.
5. In-house funds. The registration requirements contained in this notice are based on the presumption that the Dealer will only be distributing through branches of the FI mutual fund securities which are issued by a mutual fund which is sponsored by the FI or a corporation controlled by or affiliated with the FI. Mutual funds which are sponsored by a third party and managed by the FI would not satisfy this requirement. If a FI wants to sell through its branches mutual fund securities sponsored by a third party it should discuss its proposal with the securities regulator in the relevant jurisdiction to determine what amendments, if any, to the regulation of the sale of such securities are necessary.

6. Proficiency. Officers, directors and salespersons of the Dealer shall satisfy normal proficiency requirements. Some Commissions have approved courses offered by the Institute of Canadian Bankers ("ICB") and the Trust Companies Institute ("TCI") to employees of their respective members as equivalent to the IFIC mutual fund course. The relevant securities commission should be contacted to determine whether the ICB and TCI courses have been approved in that province or territory. The Commissions will also consider applications from other national industry groups, or similar organizations, to treat training courses developed by them as equivalent to the IFIC mutual fund course.
7. Premises and Disclosure. The Dealer shall carry on business in such a way as to make it clear to its clients that there is a distinction between the mutual fund business of the Dealer and the activities of the FI. This may be achieved through a combination of physical separation and signage (separate premises within the branch are not required) and shall include adequate disclosure to customers of the FI.

This disclosure shall advise clients that the Dealer is a separate corporate entity from the FI and that an investment in mutual fund securities is not insured in whole or in part by the Canada Deposit Insurance Corporation, the Regie d'assurance depots du Quebec or any other deposit insurance fund, as may be appropriate in the circumstances, is not guaranteed in whole or in part by the FI and is subject to fluctuations in market value. The specific wording of this disclosure will not be mandated by the Commissions, however, it should be prepared by each Dealer in a form which will be the same in all jurisdictions. This disclosure shall be printed in bold face type and shall appear on the following documents within the specified time frames:

- (a) prospectus: this disclosure should currently be contained in the body of the prospectus; on renewal of the prospectus this disclosure shall appear on the face page of that document;
- (b) subscription or order forms: if these forms are used (eg. order forms may not be required to process transactions initiated by telephone) the disclosure shall appear on them as soon as possible and no later than December 31, 1988; if the Dealer has existing stocks of these forms which do not contain this disclosure they may be used for no more than one year from the date of this notice provided that such existing stocks of forms are replaced as soon as possible with forms which contain the disclosure and, in the interim, the required disclosure is provided in writing to the purchaser at the time the order is made (this may be accomplished in a number of ways eg. handing out a separate document, stamping existing documents with the disclosure or using add-on stickers containing the disclosure);
- (c) confirmation slips: the disclosure shall appear on these forms as soon as possible and no later than December 31, 1988; if the Dealer has existing stocks of these forms which do not contain this disclosure they may be used for no more than one year from the date of this notice provided that such existing stocks of forms are replaced as soon as possible

with forms which contain the disclosure and, in the interim, the required disclosure is provided in writing to the purchaser at the time of delivery of the confirmation slip (this may be accomplished in a number of ways eg. handing out a separate document, stamping existing documents with the disclosure or using add-on stickers containing the disclosure);

- (d) statements of account: the disclosure is not required on these forms;
- (e) promotional material: the disclosure shall appear on all promotional material appearing or handed out in any branch of the FI (eg. newspaper advertisements are not required to contain this disclosure); if a Dealer has existing promotional material which does not contain this disclosure it may be used for no more than one year from the date of this notice provided that all of the Dealer's existing supplies of promotional material are replaced as soon as possible with material which contains the disclosure.

If the FI which is related to the Dealer lends money to a client for the purpose of purchasing mutual fund securities sold by the Dealer, the Dealer shall disclose or arrange to have disclosed to the client that the full amount of the loan must be repaid even if there is a decline in the market value of the mutual fund securities purchased with the loan proceeds. The Nova Scotia Commission may require more specifics with respect to this disclosure. Inquiries on this point should be made directly to the Nova Scotia Commission.

- 8. Administration Officer. The Dealer shall appoint an administration officer in each of its branches where mutual fund securities are being distributed to ensure that the conflicts of interest policy described in paragraph 4 is adhered to, the disclosure required in paragraph 7 is being provided, only registered salespersons of the Dealer are involved in the sale of mutual fund securities and the restrictions on certain activities as set out in paragraph 11 are adhered to. The administration officer may be an employee of the FI who is not registered to sell mutual fund securities. Unless a Commission requests the names of the administration officers it will not be necessary to provide the commissions with the names of such officers.
- 9. Branch Manager requirements. Some jurisdictions impose specific requirements on a manager of a branch of a securities or mutual fund dealer and look to that person to supervise business practices and monitor compliance with securities regulatory requirements. Such branch manager requirements are additional to the requirement that every Dealer devote adequate resources and employ appropriate systems to ensure that securities regulatory requirements are being complied with (this requirement is described in paragraph 12). The Commissions have concluded that it is not necessary to impose specific branch manager requirements on Dealers provided that:
 - (a) in accordance with paragraph 8, each Dealer appoints an administration officer in each branch of the FI which distributes mutual fund securities;

- (b) FIs adequately supervise business practices in their branches through normal operating procedures;
 - (c) the mutual fund securities sold by each Dealer are limited to funds sponsored by the FI or one of its affiliates;
 - (d) a sufficient number of qualified, registered persons are employed to monitor regulatory compliance from one or more centralized locations (this requirement is described in paragraph 12); and
 - (e) monitoring compliance with securities regulation at the FI branch level becomes a component of each Frs internal inspection process.
10. Non-registered employees. There is a statutory requirement in each province and territory that only registered salespersons of a Dealer are allowed to be involved in the sale of mutual fund securities. This requirement would preclude non-registered employees of a FI from assisting in the sale of mutual fund securities. There are, however, some activities involved in the marketing of mutual fund securities in branches of a FI that do not raise any regulatory concerns (to the extent that any of these activities constitute trading in securities each Commission will consider issuing a blanket ruling to permit them to be carried out without the need to obtain registration). Based on this analysis the Commissions have concluded that:
- (a) in any branch of a FI where there is no registered salesperson of the Dealer prospectuses and order forms may not be distributed; these documents are essential to the sale of any security and handling them out clearly constitutes a selling activity;
 - (b) in any branch of a FI where there are one or more registered salespersons of the Dealer prospectuses and order forms may be distributed; these documents may be made available to clients from a self-serve supply located in the area where the registered salesperson sells mutual fund securities;
 - (c) a non-registered employee of a FI may not distribute or assist a client with the completion of an order form for mutual fund securities;
 - (d) a client who requires assistance in completing an order form shall be directed to a registered salesperson or requested to contact a registered salesperson through the Dealer's toll-free telephone line;
 - (e) a redemption request or completed order form may be given to any employee of any branch of a FI for the purpose of processing the redemption or forwarding the order form to a registered salesperson for processing;

- (f) any branch of a FI will be permitted to advertise the availability of the mutual fund securities through the use of posters, brochures and other informational materials and may refer clients to a toll-free telephone line or the nearest branch which employs a registered salesperson; the content of any such posters, brochures or other informational material should only briefly describe the products and services offered by the Dealer; lengthy explanations of the products would not be appropriate;
- (g) any branch of a FI will be permitted to hand out account opening application forms (if the account opening application form also contains an order form paragraphs 10(a) and (b) will apply) provided that, in branches of a FI where there are one or more registered persons of the Dealer, assistance to a client in completing the form is only given by a registered person of the Dealer and, in branches of a FI where there is no registered person of the Dealer, such assistance is only given by the manager, assistant manager or credit officer in the branch who possesses a high degree of knowledge about the client's financial affairs; and before the Dealer conducts any trades on behalf of a client the completed form is approved by a registered person with the Dealer who is responsible for approving the opening of new accounts and ensuring that the know your client and suitability obligations under applicable securities legislation have been satisfied.

11. Toll-free lines. In British Columbia, Alberta and Ontario calls made on the toll-free line during normal business hours must be handled by an individual properly registered and resident in the province from which the call originates while calls made after normal business hours may be handled by an individual who is properly registered but not resident in the province from which the call originates.

In Saskatchewan and Quebec all calls made on the toll-free line must be handled by an individual properly registered and resident in the province from which the call originates.

In New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and the Yukon and Northwest Territories calls made on the toll-free line may be handled by an individual properly registered but not resident in the province or territory from which the call originates provided that the Dealer also employs registered salespersons who are resident in the province.

12. Central Office and Compliance Officer. The securities legislation in each province and territory requires every registered dealer to establish written procedures for dealing with its clients and conducting its business in accordance with prudent business practice and all regulatory requirements. It is also necessary to designate a senior official of the registrant who is registered with the local securities commission and is responsible for ensuring compliance with those procedures and all other securities regulatory requirements. These are often referred to as the "central office" and "compliance officer" requirements. It is not necessary for a Dealer to obtain

separate premises from which these responsibilities will be discharged. Any office or branch of the Dealer may be designated as its central location in a province. Similarly the compliance "officer" need not be an officer of the FI. It will be sufficient for the compliance officer to be a senior manager of the Dealer and the FI so that the relevant securities commission can be satisfied that the compliance function is being handled by an individual who is senior enough in the organization to ensure that compliance with the rules is adhered to. The proficiency or experience requirements for a compliance officer will be those currently established in each province or territory. As noted in paragraph 9, it is the responsibility of each Dealer to ensure that all regulatory requirements are being complied with. Among other things this requires each Dealer to employ an adequate number of registered, qualified compliance personnel to properly handle the Dealer's volume of business. These compliance employees will be in addition to the Dealer's designated compliance officer. The Alberta Commission has concluded that, as a minimum, the obligation to devote adequate resources to the compliance function will require each Dealer to have in the province at least one registrant who has successfully completed the Partners', Directors' and Senior Officers' Qualifying Examination and at least one other registrant who has successfully completed the Branch Managers' Examination. The Alberta Commission will consider variations from this requirement in exceptional circumstances. Any questions on this matter should be directed to the Alberta Commission.

13. Electronic Sales. Sales of mutual fund securities through electronic means (eg. automated teller machines) will not be permitted. As technology advances the Commissions will be prepared to review this restriction at the request of one or more Dealers or FIs. This limitation will not be interpreted to restrict sales activity conducted by telephone or other means through which a registered salesperson may communicate directly with a customer. Electronic means may be used to effect redemptions or payments for prior purchases of mutual fund securities.

14. Completion of Form 4A/3A. It is a requirement of provincial and territorial securities legislation that every applicant for registration as a salesman of a registered dealer complete Form 4 or, in Quebec, Form 3 in the form prescribed by securities legislation. These Commissions recognize that not all of the content of this form may be relevant to the activities of salespersons of Dealers carrying out the trading activity contemplated by this notice or to the activities of other registrants carrying out directly competing activities. Accordingly, the CSA has authorized the Subcommittee to institute a review of this form to determine if it can be shortened and simplified for the benefit of all applicants for registration. Although this process will commence in the near future it will not be concluded for some time. The Commissions concluded that it would not be sensible to require every salesperson of all FI related Dealers to complete a Form 4/3 at a time when the content of that document is under review. As an interim measure while Form 4/3 is being reviewed salespersons of Dealers will not be required to complete and file Form 4/3 provided that:
 - (a) each salesperson of a Dealer completes an abbreviated registration application (i.e, Form 4A/3A) substantially in the form attached as Schedule "A" hereto, and

- (b) each Dealer and its related FI undertake in writing to each securities commission that it shall grant to such commission the right to immediate access upon request to the personnel records maintained by the Dealer and the FI with respect to each registered salesperson of the Dealer; it will be acceptable to limit such access to information which a registrant is normally obliged to make available to the securities commission.

By following this process the FI will be presumed to be acting as a character reference for each salesperson being registered in its related Dealer. In most provinces and the territories salespersons will be registered upon receipt by the relevant Commission of a properly completed Form 4A/3A on the condition that a salesperson's registration may be revoked if the Commission does not receive a satisfactory response to police record inquiries. In Saskatchewan salespersons of the Dealer will not be registered until the Saskatchewan Commission receives a preliminary favourable response to its police record inquiries.

- 15. Record-keeping. Securities legislation in each province and territory requires every registered dealer to maintain prescribed books and records. The Subcommittee has been asked to permit this activity to be performed by the related FI on behalf of the Dealer, is essential that each registrant be in control of its books and records to enable it to discharge regulatory requirements and to allow the Commissions to have access to necessary information as may be required from time to time. Accordingly, FIs will be permitted to maintain the books and records of a related Dealer provided that the Commissions receive written assurance that the Dealer's books and records can be produced separately at any time and that each Commission will be given immediate access to such books and records (including copies of all supporting documents) on request. Such books and records may be electronically stored in a central location provided that such books and records as are required to carry on the Dealer's business in the province or territory are maintained in that province or territory and each commission receives written assurance that such centrally stored information will be available to each commission upon request.
- 16. Reporting. Securities legislation in each province and territory requires that certain reports (eg. confirmation of trades, statements of account) be sent to clients of a dealer on a periodic basis. In some cases compliance by a Dealer with these requirements could result in a duplication of reporting (eg. a mutual fund security purchased for a RRSP account) which would be both costly and potentially confusing to the client. Accordingly, the reporting requirement will be waived if it would result in a duplication of reports and information. Each Dealer must satisfy itself that the report of the FI is truly duplicative, both in terms of content (eg. see requirement for confirmation slip disclosure in paragraph 7(c)) and frequency (eg. reports must be sent in respect of each purchase of mutual fund securities and each subsequent transaction within a client's account), of the requirements of securities legislation.
- 17. Other requirements. Each Dealer shall comply with all applicable provisions of National Policy 39 and also must satisfy all of the normal registration requirements of each jurisdiction to the extent that such requirements are not addressed in this notice. These requirements include completion of Form

3 or, in Quebec, Form 2, obtaining appropriate bonding and insurance coverage (the Dealer may be covered by an extension of appropriate coverage already carried by the related FI), complying with capital requirements, participation in the applicable contingency fund (if any) and providing reports to the securities commissions.

Reference:

B.C.	-	Andrew Walker (604) 660-4800
Alberta	-	Walter Kunicki (403) 427-5201
Sask.	-	Barbara Shourounis (306) 787-5842
Manitoba	-	Tom Tapley (204) 945-2548
Ontario	-	Jamie Scarlett (416) 593-8211
	-	Joan Smart (416) 593-3666
Quebec	-	Pierre Lize (514) 873-5326
N.S.	-	Nick Pittas (902) 424-7768
N.B.	-	Donne Smith (506) 658-2504
P.E.I.	-	Merrill Wigginton (902) 368-4563
Nfld.	-	George Kennedy (709) 576-3316
Yukon	-	Malcolm Florence (403) 667-5225
N.W.T.	-	Gerald Stang (403) 873-7490

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