

**Oversight Review Report of  
the Mutual Fund Dealers Association of Canada**

**Issued: November 18, 2016**

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## **I. Introduction**

The Mutual Fund Dealers Association of Canada (MFDA) is the national self-regulatory organization (SRO) for the distribution side of the Canadian mutual fund industry. The MFDA's head office is in Toronto and regional offices are in Calgary and Vancouver.

The MFDA is recognized as a SRO by the Alberta Securities Commission (ASC), the British Columbia Securities Commission (BCSC), the Financial and Consumer Affairs Authority of Saskatchewan (FCAA), the Financial and Consumer Services Commission of New Brunswick (FCNB), the Manitoba Securities Commission (MSC), the Nova Scotia Securities Commission (NSSC), the Ontario Securities Commission (OSC), and the Prince Edward Island Office of the Superintendent of Securities, collectively, the Recognizing Regulators.

The MFDA is not recognized as a SRO in Québec. The MFDA cooperates with the Autorité des marchés financiers (AMF) in regulating MFDA member firms with operations and activities in Québec.

This report details the objectives, methodology, frame of reference, report format, scope, overall assessment, and findings of the oversight review completed in November 2015 by the participating Recognizing Regulators for the review period from July 1, 2012 to July 31, 2015.<sup>1</sup> Staff from the ASC, BCSC, FCAA, FCNB, MSC, NSSC, and OSC (Staff) conducted the review jointly.

In addition, BCSC and OSC staff conducted a targeted review of the MFDA's information technology and risk management areas on behalf of the Recognizing Regulators in January 2015. The results of that review are set out in Appendix B.

### **1. Objective**

The objective of the oversight review was to evaluate whether selected regulatory processes were effective, efficient, and applied consistently and fairly, and whether the MFDA complied with the terms and conditions (T&Cs) of the Recognizing Regulators' recognition orders (ROs).

### **2. Methodology**

The Recognizing Regulators used a risk-based approach in this review. The Recognizing Regulators:

- assessed the inherent risks of each functional area of the MFDA based on:
  - discussions with senior MFDA personnel
  - reviews of internal MFDA documentation, including annual management self-assessments

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<sup>1</sup> Staff reviewed files that were outside the review period for financial compliance examination and desk review files.

- information received from the MFDA in the ordinary course of oversight activities
- evaluated known control functions for each area
- considered relevant situational/external factors such as market conditions and regulatory changes
- calculated an initial overall risk score for each area
- discussed with the MFDA staff the effectiveness of mitigating controls in specific functional areas
- calculated an adjusted overall risk score for each area
- used the adjusted risk scores to determine the scope of the review

### **3. Frame of reference**

Staff performed an oversight review of the MFDA in 2012. Staff issued and published a report of that review on April 17, 2013 (the 2013 Report), noting a number of findings. The 2013 Report also included the MFDA's commitments and timelines to resolve the findings as well as Staff's plans for follow-up and monitoring.

Since the last oversight review, the MFDA continues to face many challenges in conducting its regulatory responsibilities. As part of the risk assessment process, Staff followed up on the MFDA's progress in resolving the 2013 Report findings, and also considered the challenges faced by mutual fund dealers and the MFDA, including:

- *Stakeholder expectations:* As a SRO, the MFDA must fulfill its regulatory mandate while balancing its resources with the needs and expectations of the investing public, its members and the mutual fund industry in unsettled economic conditions.
- *Industry developments:* Unsettled economic conditions, investor demands for investment returns and changing regulatory requirements continue to put pressure on the business of MFDA dealers. Also, demographic changes (e.g. an aging population and a technology-savvy younger generation of investors) impact the delivery of investment services. To keep pace with these changes, the MFDA updated its strategic plan, refreshed aspects of its risk-management framework, and further developed member and public educational resources.
- *Changing regulations:* Changes in the regulatory landscape are also a challenge to the MFDA and many of its members. For example, mutual fund dealers are required to understand and implement changes to processes and systems to comply with new performance and fee disclosure requirements. The MFDA must maintain robust policy development and staff education processes to ensure appropriate interpretation and application of new regulations.
- *Technology:* The MFDA must continue to allocate significant resources to information security due to the increased cyber-security concerns.

#### 4. Report format

In keeping with a risk-based approach, the report only cites key processes with findings that require corrective action, by functional area. While the MFDA is required to respond to all findings, some findings do not concern every MFDA office. In those cases, the MFDA must correct deficiencies as necessary to ensure consistency in all MFDA offices.

#### 5. Scope

Based on the risk assessment, as well as the status of the resolution of the findings noted in the 2013 Report, Staff selected specific processes and activities<sup>2</sup> within the following high and above-average risk areas for review:

- Enforcement
- Financial compliance
- Policy
- Sales compliance

The risk assessment determined that the following moderate and low risk areas did not require examination during this review:

- Business continuity plan
- Cooperative agreement in Québec
- Corporate governance
- Financial viability and fees
- Information technology (IT)
- Membership
- Risk management

All functional areas are subject to oversight by the Recognizing Regulators through ongoing mandatory reporting by the MFDA as required by the ROs, as well as regularly scheduled and ad hoc meetings between the Recognizing Regulators and MFDA staff.

#### 6. Finding prioritization

Staff prioritized all findings as high, medium, or low, based on the following criteria:

**High** The issue is significant or is a significant repeat finding. MFDA must take immediate corrective action and regularly report on its progress.

**Medium** The issue is moderately significant. The MFDA is required to resolve the issue within a reasonable timeframe and periodically report on its progress.

**Low** The issue is less significant. Staff raises the issue with MFDA management for resolution within a reasonable timeframe.

#### 7. Summary of findings and assessment

Staff noted high priority findings in the enforcement (two) and financial compliance (one) departments. Staff also noted medium priority findings in the enforcement (two),

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<sup>2</sup> The processes and activities are described in more detail in the body of the report.

financial compliance (two) and policy (one) departments. Staff acknowledge significant progress in resolving findings cited in the 2013 Report and Staff will continue to monitor the MFDA's progress in taking corrective action on the findings detailed within the report in accordance with the priority assigned.

High and medium priority findings are set out in the *Fieldwork & Findings* section of the report. Low priority findings are set out in Appendix A.

Based on the risk assessment, the work performed, and the results of the review, other than the findings noted, Staff found that MFDA processes were effective, efficient, and applied consistently and fairly. Staff did not identify concerns with the MFDA meeting the relevant T&Cs of the ROs in the areas reviewed.

## II. Fieldwork and findings

### A. Enforcement

T&C #8 of the RO requires the MFDA to discipline its members and their Approved Persons who violate MFDA rules and cooperate with the Recognizing Regulators in the enforcement of applicable securities legislation. The MFDA enforcement department is responsible for enforcing compliance by its members and their Approved Persons.

MFDA enforcement staff are organized into the following groups:

- case assessment
- investigation
- litigation

The inquiries group in the membership services department receives initial public inquiries and directs complaints to the case assessment group.

Enforcement staff are primarily responsible for:

- assessing case files
- investigating complaints or referrals about possible regulatory misconduct
- taking disciplinary action in cases of misconduct

Staff's primary objective of this part of the review was to evaluate the efficiency and effectiveness of the MFDA enforcement functions. Staff reviewed the organizational structure and staffing to assess staff resources in the pacific regional office, and litigation resources in both the pacific regional and head offices.

Staff also reviewed the following:

- length of time it takes to close an enforcement case
- membership services department directing complaints to case assessment
- enforcement department relying on investigations conducted by members
- impact of a reduced scope of the standard document request list that MFDA staff provides to members
- tracking of cases referred to or from the MFDA and other regulatory bodies, or law enforcement agencies
- posted regulatory notes on the National Registration Database (NRD)
- the disposition of signature falsification cases
- the MFDA's "bulk-track<sup>3</sup>" process
- reduced compensation of hearing panel members
- the Ombudsman for Banking Services and Investments (OBSI) cases

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<sup>3</sup> The MFDA adopted the bulk-track process in 2012 to promote efficiency by combining similar case types and agreed statements of fact before a single hearing panel.

Staff interviewed the Senior Vice-President, Member Regulation - Enforcement, Enforcement Directors, and other staff. Staff reviewed the MFDA's enforcement policies and procedures, and a sample of enforcement files.

Staff noted that some enforcement case files remained open for long periods. Staff met with the MFDA to understand the reasons, some of which were beyond the MFDA's control, that contributed to case files remaining open for longer periods. Minimizing the time required to complete cases is important to effective investor protection. As part of its ongoing oversight, Staff will continue to consider the time it takes to close enforcement files.

Staff found a number of significant weaknesses in the processes and/or policies reviewed in the area that require immediate corrective action as noted below. In addition to the following findings, other low priority findings are noted in Appendix A.

**(1) Finding – Escalation of signature falsification cases**

Prior to the creation of the Enforcement Case Handling Guidelines – Signature Falsification, in April 2014, a case that involved a large number of affected clients, falsified client documents and pre-signed forms, was closed with a warning letter issued by the case assessment group. Given the duration of the activity and the particular circumstances, Staff noted that the case should have been escalated to the investigation group for review and further action.

As part of the review, Staff was informed that the new guidelines are assisting the MFDA in ensuring that signature falsification cases are dealt with appropriately.

<b>Risk Implication</b>	Failure to take appropriate enforcement action in signature falsification cases undermines the effectiveness of the enforcement of MFDA rules and understates the seriousness of the misconduct.
<b>Priority</b>	High
<b>Requirement</b>	Staff acknowledge that the MFDA has taken steps to address this issue. Please describe any further corrective action that the MFDA proposes to take concerning signature falsification cases.
<b>MFDA's Response</b>	The MFDA considers the use of falsified documents and pre-signed forms to be serious misconduct and in January 2015 we implemented specialized screening and case handling procedures to deal with those cases.



	<p>In October, 2015, MFDA Staff issued Bulletin #0661-E Signature Falsification, reminding Members and Approved Persons that all signature falsification is unacceptable and creates harm for clients. The bulletin also reminded Members and Approved Persons that in the period 2012 to 2014, the MFDA commenced 41 proceedings against Approved Persons regarding signature falsification.</p> <p>The MFDA is taking further action on items referenced in the Bulletin. We have increased the penalties we seek and will be further increasing those penalties for activity that has occurred after the issuance of the Bulletin. Staff will also be publishing further guidance for Members, Branch Managers and supervisory personnel on supervising, investigating and taking internal disciplinary action regarding such activity.</p> <p>During our most recent fiscal year July, 2015 to June, 2016, MFDA Staff commenced 58 formal disciplinary proceedings against Approved Persons and Branch Managers regarding signature falsification.</p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff are encouraged that the MFDA has taken further action such as increasing penalties for activity and the publication of further guidance. Staff expect the MFDA to seek suspensions, as warranted, and to monitor and report on the effectiveness of the processes in place by January 31, 2017.</p>

<p><b>(2) Finding – Cases against dealer members</b></p> <p>In its review of proceedings conducted during the period under review, Staff found in a few cases against approved persons in which it was not clear why the dealer member was not also named as a respondent.</p>	
<p><b>Risk Implication</b></p>	<p>Only taking action against Approved Persons, and not dealer members when warranted, undermines the effectiveness of enforcement activity, and does not address issues of supervisory and executive responsibility for the conduct of Approved Persons.</p>
<p><b>Priority</b></p>	<p>High</p>

<b>Requirement</b>	Please describe the plan for immediate corrective action that the MFDA will take to address this significant finding, including a timeline for resolution.
<b>MFDA's Response</b>	<p>MFDA Staff view the issue of appropriate supervision as being highly important. We have procedures to investigate the supervisory activity by Members, Branch Managers and other supervisory personnel in all cases and commence formal proceedings as appropriate.</p> <p>We are currently reinforcing our procedures with Enforcement Staff, and we have amended our Escalation Committee practices to review draft reports to ensure we fully document our reasoning in cases where no action is taken. We have also developed an additional management report containing information on current Member cases to assist in reviewing the status of and monitoring those cases.</p>
<b>Staff Comments and Follow-up</b>	Staff note that the MFDA has amended its Escalation Committee practices and developed an additional reporting tool, and is reinforcing its investigative procedures pertaining to supervisory activity with Enforcement Staff. Staff expect the MFDA to take action against dealer members to address the lack of supervisory and executive responsibility when warranted, and will require the MFDA to monitor and report on the effectiveness of the processes noted above by January 31, 2017.

**(3) Finding – Allocation of resources**

In 2012, the MFDA implemented procedures designed, in part, to address concerns about the sufficiency and allocation of enforcement resources (including staff) by streamlining disciplinary action in routine enforcement cases. Rather than an increase in the issuance of Wells letters<sup>4</sup>, staff noted that the number of cases closed with warning letters more than doubled between 2012 and 2013. As well, staff noted multiple instances where there was a significant delay in the litigation group issuing Wells letters to respondents.

It is not clear that the revised processes alleviated concerns about the sufficiency or allocation of enforcement resources. Staff understands that the MFDA is currently reassessing the allocation issue, as well as the possible need for additional staff.

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<sup>4</sup> A Wells letter informs the recipient of the enforcement staff's recommendation to begin a disciplinary hearing against the recipient and outlines the allegations and supporting evidence.

<b>Risk Implication</b>	Insufficient or misallocated resources may adversely impact the effectiveness of the MFDA’s enforcement functions.
<b>Priority</b>	Medium
<b>Requirement</b>	Please describe the action the MFDA will take to address this matter, including a timeline for resolution.
<b>MFDA’s Response</b>	<p>In 2012, MFDA Staff commenced the development and implementation on a pilot basis of bulk-track procedures designed to deal more efficiently with routine cases that comprise a significant portion of our overall caseload. The ongoing development of those procedures in current form was completed in January 2015, and MFDA Staff continues to monitor those procedures for possible enhancements.</p> <p>The number of warning letters issued (rather than formal proceedings commenced) by the Litigation group increased in 2013 for a number of reasons. The overall caseload increased from previous years; MFDA Staff commenced 65 proceedings in 2013 which was a 35% increase over the prior year and, at that point, was the highest number of proceedings commenced in any year. Warning letters were also issued to screen out less serious cases, some of which would not be escalated under the current guidelines. In other cases, MFDA Staff identified concerns with the sufficiency of the available evidence, including witness availability.</p> <p>MFDA Staff recognized this issue at the time and addressed it by way of ongoing revisions to the bulk-track process, including the use of dedicated Enforcement Counsel, templated documents, focusing on early resolution, and creating a specialized duty hearing panel. MFDA Staff also revised its signature falsification guidelines as noted above, and increased the involvement of Enforcement Counsel during the investigation process. As a result of these changes, the number of warning letters issued by the Litigation group subsequently declined; by 2015, it had decreased by over 85% from 2013 levels.</p> <p>During the entirety of the period referred to above, MFDA</p>

	<p>Staff met or exceeded applicable benchmarks with the existing staff complement. In 2016, MFDA Staff increased its complement of Enforcement Counsel to address a further increase in workload.</p> <p>Some regulatory organizations, including the MFDA, engage in a practice of providing Wells letters, where appropriate, to potential respondents. A formal Wells letter is not required in all cases. MFDA Staff recognizes that it is preferable to issue Wells letters earlier in the litigation process. MFDA Staff has enhanced its management reports by including dates of issuance of Wells letters to better enable managers to monitor the delivery of Wells letters, and is reinforcing with Staff the need to send Wells letters earlier in the litigation process.</p>
<b>Staff Comments and Follow-up</b>	<p>Staff are encouraged that the MFDA monitors procedures it implemented for the bulk track process for possible enhancement and has enhanced its management reports to monitor better the delivery of Wells letters. Staff expect the MFDA to have adequate and efficient resources and will require the MFDA to continue to monitor and report on their effectiveness by January 31, 2017.</p>

<b>(4) Finding – Timeliness of postings on NRD</b>	
<p>The MFDA is required to add regulatory notes, concerning MFDA members or Approved Persons, to NRD to improve transparency between regulatory agencies. Staff found instances of delay in posting the opening and closing dates of reviews in NRD.</p>	
<b>Risk Implication</b>	<p>Failure to document an ongoing member or Approved Persons review in NRD on a timely basis reduces the transparency of MFDA disciplinary processes and increases the regulatory risks to those relying on NRD for information regarding members or Approved Persons.</p>
<b>Priority</b>	<p>Medium</p>
<b>Requirement</b>	<p>Please describe the action the MFDA will take to address this matter, including a timeline for resolution.</p>
<b>MFDA’s Response</b>	<p>We understand the need for those securities regulatory staff who rely on NRD to see certain MFDA case data on the NRD system. We also provide more comprehensive</p>

	<p>regular reporting of case-related information by other means to other staff at the individual provincial securities regulators.</p> <p>We have implemented an additional feature on our case tracking system that highlights and prompts staff to enter certain information on NRD. In addition, we are exploring the development of other controls to help manage the risk of human error and ensure that data is consistently entered.</p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff note the enhancements made to the case tracking system. Staff expect the MFDA to have processes in place to ensure the required data is inputted on a timely basis, and will require the MFDA to monitor and report on the effectiveness of the enhancements and other controls by January 31, 2017.</p>

## B. Financial compliance

T&C #7 of the RO requires the MFDA to conduct periodic examinations of its members and Approved Persons to ensure they comply with MFDA rules.

To ensure that members comply with prudential requirements, the MFDA's financial compliance staff:

- review member financial filings to ensure that members maintain and report adequate capital in accordance with MFDA rules
- conduct on-site financial compliance examinations
- review member auditor working paper files

In this section of the review, Staff evaluated the effectiveness and efficiency of the MFDA financial compliance functions. Staff reviewed:

- the application of the MFDA's risk-based methodology to ensure that the:
  - criteria for assessing member risk are reasonable
  - criteria for selecting members for examination are reasonable
  - scheduling of financial compliance examinations corresponds to the associated financial compliance risk score
- staff resources and reporting structure to ensure the MFDA has:
  - sufficient qualified staff to perform financial compliance reviews, particularly for level 2 and 3 dealers<sup>5</sup>
  - adequately supervised staff performing financial compliance reviews under the new risk-based approach
- quality of financial compliance examinations to ensure that:
  - changes to the financial compliance module are reasonable and address deficiencies identified
  - staff completing financial compliance reviews received adequate training on the risk-based approach
  - all financial compliance examination working papers are reviewed by a supervisor
  - adequate and timely follow-up of member responses to findings in financial compliance examination reports is carried out
- auditor working papers (AWPs) to ensure that:
  - cycles for review of members' AWP are reasonable and include provision for changes, including changes in a member's auditor
  - benchmarks for the review of members' AWP are monitored and followed-up on, as necessary, on a timely basis

Staff interviewed the Senior Vice-President, Member Regulation - Compliance, the Managing Director, Financial Compliance, and other staff. Staff reviewed policies and

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<sup>5</sup> Level 2 member dealers do not hold client cash, securities, or other property and do not operate trust accounts. Level 3 member dealers do not hold client securities or other property in their name except client cash in a trust account. Both Level 2 and 3 member dealers conduct business in client name only.

procedures, including the financial compliance program for examinations and the financial examiner reference manual. Staff reviewed a sample of financial compliance examination and AWP files to assess the quality of files.

Staff are satisfied that the MFDA appropriately resolved the AWP benchmark related finding identified in the 2013 Report, but noted several areas, including the AWP process, for improvement as noted below. In addition, one low priority cross-departmental finding is noted in Appendix A.

**(1) Finding – Member responses to examination files**

To ensure that the oversight review objectives for the financial compliance group were met, Staff reviewed a subset of examination files, some of which were outside the review period. In one such examination file, the MFDA raised a finding citing four instances in which the member did not provide supporting documentation necessary to complete specific examination procedures. A similar finding was noted in the previous examination of the member, and the MFDA wrote to the member stating that providing information and supporting documentation subsequent to the examination was not acceptable to the MFDA, and failure to provide all required documentation on a timely basis during the subsequent examination might lead to (i) additional fees for excessive attention, (ii) designating the member into discretionary early warning and / or a referral to the MFDA enforcement department.

One of the cited instances described in the finding pertained to the member's inability to provide supporting documentation for related party transactions, and referenced MFDA rules requiring members to maintain adequate books and records for the proper recording of its business, and to provide access to the MFDA. The MFDA subsequently corresponded with the member to clarify that the member would provide the supporting documentation. The member agreed to provide the supporting documentation. Staff did not find the supporting documentation in the file.

Staff was later informed by the MFDA that in a verbal discussion with the member, the member represented that it did not retain documentation to support the nature and calculation of the related party balances. Staff was also informed that the MFDA interpreted the member's response that it would provide the supporting documentation to mean only on a going forward basis during the next examination. Staff did not find documentation or notes within the file specifically evidencing the MFDA's interpretation, and the examination file was closed despite the MFDA's position noting that it was not acceptable to provide information and supporting documents subsequent to the examination.

Adequate books and records are a cornerstone of a proper regulatory framework. Given the repeat finding and prior year letter, the MFDA should have taken more timely follow-up action to ensure that the finding was adequately resolved.

<b>Risk Implication</b>	The failure to secure necessary documentation may undermine the integrity of the examination process because important issues may not be included in the examination report.
<b>Priority</b>	High
<b>Requirement</b>	Please describe the action the MFDA will take to address this matter, including a timeline for resolution.
<b>MFDA's Response</b>	<p>We agree that maintaining books and records in accordance with MFDA Rule 5 is important. The Member in question was subject to an annual examination and the MFDA intended on determining if it was maintaining a record of the calculation during the next examination. In addition, as is the case with all Members, MFDA Staff was monitoring the Member's financial activity and capital position on a monthly basis by reviewing financial reports the Member filed with the MFDA.</p> <p>With respect to cost sharing arrangements in general, MFDA Staff's concerns are with the validity of the shared expenses. In order to address such concerns with all Members, the MFDA undertook a review of Member cost-sharing arrangements and issued a Bulletin dated December 29, 2014, Cost Sharing Arrangements. The Bulletin provides guidance to Members on the use and implementation of cost sharing agreements. The recommendations provided in the Bulletin are considered when MFDA Staff assess Member cost sharing agreements during regular on-site examinations.</p>
<b>Staff Comments and Follow-up</b>	Staff are encouraged that the MFDA agrees that the maintenance of adequate books and records is important. However, as noted in the finding, the MFDA should have done more to resolve the issue. Staff expect the MFDA to review its internal processes and to develop or clarify procedures by January 31, 2017 to ensure that more timely follow-up action is taken, as applicable.

**(2) Finding - AWP reviews**

MFDA members are required to appoint auditors that meet the qualifications set out in MFDA Rule 3.6.8. MFDA's Financial Examiner Reference Manual requires financial



compliance staff to review AWP's of the members' annual audited Form 1<sup>6</sup>. Members' auditors are required to conduct the audit in accordance with MFDA Rule 3.6.

In 2011, the MFDA established a four-year cycle for reviewing the AWP's of each member's auditor.

Staff found that MFDA financial compliance staff:

- reviewed AWP's as long as 15 months after the completion of members' fiscal year-ends, which did not allow auditors sufficient time to address deficiencies before the next annual audit.
- did not follow up on significant issues found in AWP reviews in the year following the AWP review.
- did not perform follow up reviews of AWP's when the member engaged a new audit partner or firm. Compliance staff intended to review the working papers of the new audit partner or firm during the following four-year cycle, resulting in a significant delay in the review of the new auditors' AWP's.

<b>Risk Implication</b>	The failure to review AWP's to ensure that a member's auditor understands and complies with MFDA rules may result in a failure to resolve significant deficiencies in the audit work. As well, not providing timely feedback to member auditors will reduce the opportunity for improvement in the quality of future audit work.
<b>Priority</b>	Medium
<b>Requirement</b>	Please describe the action the MFDA will take to address this matter, including a timeline for resolution.
<b>MFDA's Response</b>	We agree that reviews of AWP's should be performed, where practical, on a timely basis following completion of the engagement. However, there were also a number of other factors we consider when scheduling AWP reviews. These factors include: efficient use of resources; travel costs associated with the review; and the availability of the audit firm to accommodate our review. In the cases noted by CSA Staff, MFDA Staff completed multiple AWP reviews during the same trip out of province in order to minimize travel costs and selected an AWP for review where an audit firm was able to accommodate our request during a busy time of the year for audit firms.

<sup>6</sup> MFDA Rule 3.5.1 requires members to file, monthly and annually, a Form 1 that includes financial statements and schedules.

	<p>A new AWP risk-based review cycle commenced January 1, 2016. The process was amended to address CSA Staff's concerns noted above.</p> <p>We note that the AWP review process is just one of the core regulatory processes performed by financial compliance staff. MFDA Staff perform desk reviews of all Members' monthly unaudited and annual audited financial reports as well as perform regular on-site compliance examinations of all Members' financial operations.</p>
<b>Staff Comments and Follow-up</b>	<p>Staff note that the MFDA incorporated a risk-based review cycle to address the issue. As MFDA staff rely in part on the work performed by a member's external auditor, Staff expect the MFDA to have adequate processes in place to review AWPs on a timely basis, and will require the MFDA to monitor and report on the effectiveness of the new AWP risk-based review process by January 31, 2017.</p>

<b>(3) Finding – Quality and consistency of working papers</b>	
<p>Staff noted a memorandum in one review that cited specific concerns about a member's oversight of its outsourced investment fund management operations, however, the concerns noted in the memo were not carried forward to a report. The applicable financial compliance manager's hand written notes on the memo indicated that, as per discussions with the Managing Director, Financial Compliance, the member's oversight procedures as described in the same working papers appeared reasonable. Even though there was an appropriate process in place to escalate the examiner's concerns, neither the financial compliance manager nor the Managing Director, Financial Compliance provided a written explanation of why the examiner's concerns were not accepted, or how existing oversight procedures address the concerns raised.</p>	
<b>Risk Implication</b>	<p>Failure to document the rationale for the resolution of noted concerns may undermine the integrity and effectiveness of the examination process.</p>
<b>Priority</b>	<p>Medium</p>
<b>Requirement</b>	<p>Please describe the action the MFDA will take to address this matter, including a timeline for resolution.</p>
<b>MFDA's Response</b>	<p>We agree that the working paper referred to above should have been updated to reflect that the Member's oversight</p>

	procedures were considered satisfactory.
<b>Staff Comments and Follow-up</b>	Staff are encouraged that the MFDA agrees that the documentation in the file was incomplete. Staff expect the MFDA to review its internal processes and to develop or clarify procedures by January 31, 2017 to ensure that updates to working papers are completed, as applicable.

**C. Policy**

T&C #10 of the RO requires the MFDA to establish by-laws, rules, regulations, policies, forms, and other similar instruments as are necessary or appropriate to govern and regulate all aspects of its business and affairs. The MFDA policy department is responsible for:

- policy initiatives that address regulatory issues
- interpreting rules through member regulation notices

The primary objective of this part of the oversight review was to determine whether the MFDA:

- took appropriate action since the 2013 Report to remove from staff notices any prescriptive language that is not supported by a rule and clarify that staff notices are for guidance only, and do not constitute rules
- used prescriptive language that is not supported by a rule in bulletins which are only intended to provide information
- had appropriate internal approval processes, including procedures for the delegation of decision making to staff

Staff interviewed the MFDA’s General Counsel, Corporate Secretary and Vice-President, Policy, and other senior management. Staff reviewed:

- Policy Advisory Committee materials
- a sample of notices and bulletins
- other policy-related documents

Staff found one area requiring improvement as noted below. In addition, one low priority finding is noted in Appendix A.

**Finding - Approvals authorization**

The MFDA does not have an effective process to ensure that decisions made on behalf of the Corporation are made only by individuals authorized under the MFDA General By-law and Rules. Furthermore, the process to delegate the specific powers and duties was not appropriately documented in all cases.

<b>Risk Implication</b>	Without adequate processes to confirm authority to act for the Corporation, the legitimacy of the decision-making may be undermined.
<b>Priority</b>	Medium
<b>Requirement</b>	Please describe the action the MFDA will take to address this matter, including a timeline for resolution.

<b>MFDA's Response</b>	As discussed with CSA Staff, the Corporation has developed position descriptions and internal processes that are consistent with the By-law and aim to ensure that authorized individuals only make decisions within the scope of their authority and in a manner consistent with MFDA Rules. In order to address the comments of CSA Staff with respect to documentation, we have enhanced our internal documentation procedures to provide greater clarity with respect to the scope of authority of individuals authorized to act for the Corporation in accordance with MFDA Rules and By-law.
<b>Staff Comments and Follow-up</b>	Staff are encouraged that the MFDA revised its internal documentation. Staff expect the MFDA to have adequate processes in place to ensure the legitimacy of decisions, and will require the MFDA to monitor and report on the effectiveness of the enhancements and other controls in place by January 31, 2017.

## **D. Sales compliance**

T&C #7 of the RO requires the MFDA to conduct periodic examinations of its members and Approved Persons to ensure compliance with MFDA rules.

The MFDA's sales compliance department performs on-site sales and business conduct examination of members. In 2012, the sales compliance department adopted a new risk-based approach to selecting members to examine. Previously, the department reviewed each member once every three years. Under the new approach, the MFDA examines members once every two or four years, depending on the risk rating of the member.

The objective of this part of the review was to evaluate the efficiency and effectiveness of the MFDA's sales compliance functions.

Staff reviewed:

- the resolution of a 2013 Report finding on the timeliness of the closing of examinations
- compliance programs and changes made to the programs since the previous review
- staffing resources to determine if processes were handled in a timely manner
- MFDA compliance processes to determine if the sales compliance group identified and documented deficiencies in a timely manner
- the effectiveness of targeted-examination processes, branch review policy, and syndicated mortgage referral review processes

Staff interviewed the Senior Vice-President, Member Regulation - Compliance, the Managing Director, Sales Compliance, and other staff. Staff reviewed the policies and procedures used by sales compliance staff, including the sales compliance risk model, sales compliance examination program, the compliance officer manual and the sales compliance examination schedules. Staff reviewed a sample of compliance examination files, including examinations of head and branch offices, to assess the quality of examinations performed.

Staff noted one low priority cross-departmental finding set out in Appendix A.

### III. Appendix A – November 2015 oversight review low-priority findings

Functional Area	Staff Findings	MFDA's Response	Staff Comments
Cross department	<p><u>Review of risk criteria</u></p> <p>There was no formal schedule to review<sup>7</sup> the financial compliance, sales compliance, and enforcement risk models used to assess and rate member risk to ensure continued relevance.</p>	<p>The MFDA has performed reviews of its risk model periodically and will formalize an annual review in its policies and procedures.</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>
Enforcement	<p><u>Documenting review of OBSI cases</u></p> <p>The MFDA reviews all OBSI reports to determine if they contain new information or different facts. If no new information or facts are found, the matter remains closed and the MFDA does not document their review.</p>	<p>MFDA Staff carefully review all published OBSI recommendations. Where we identify new information, we open or reopen a case or add the new information to an existing case as appropriate, and we document our review. We will now also document our review in those cases where no new information is identified.</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>
Enforcement	<p><u>Finding – Tracking of referrals to third parties</u></p> <p>The AMF often investigates mutual fund dealer cases when the majority of affected clients reside in Québec. When the AMF opens an investigation, the MFDA may close its file and track the status of the</p>	<p>As noted in the finding, Staff has a procedure to track the status of cases referred to other regulators. In the situation noted by the CSA,</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>

<sup>7</sup> The review should include an assessment of risk model components such as relevance and suitability of risk categories, specific risk factors and criteria assigned to risk factors, suitability of scores assigned to each criterion and suitability of weighting assigned to the specific risk factors.

Functional Area	Staff Findings	MFDA's Response	Staff Comments
	<p>AMF investigation. In these cases, MFDA systems prompt the applicable MFDA staff to monitor the status of the AMF file on a predetermined frequency. Staff noted an example where MFDA staff did not evidence follow up of the AMF work in the file over a three-year period.</p>	<p>the MFDA Staff member followed the procedure except during the period when she was absent on leave. The receiving regulator continued with the case throughout the period and recently commenced formal proceedings. MFDA Staff have amended the procedure so that the relevant manager will be prompted to perform the follow-up process when an employee goes on leave.</p>	
Policy	<p>Finding - Clarity in the regulatory implications of Staff Notices (previously, called Member Regulation Notices)</p> <p>The 2013 Report recommended that the MFDA continue to clarify the regulatory status of staff notices, and develop and implement processes to ensure that notices do not contain language that might be interpreted or applied as rules. To address this, the MFDA undertook and completed the Policy Instrument Review Project. However, Staff noted that prescriptive language used in one notice required action by Approved Persons that was substantially different from the rule. This is inconsistent with the interpretative, as opposed to prescriptive, nature of notices.</p>	<p>The finding relates to MFDA Staff Notice 0025 – Suitability Obligations for Unsuitable Orders. The Notice states that Approved Persons must clear unsuitable, unsolicited orders with their branch managers or compliance officer before proceeding with the trade.</p> <p>MFDA Policy No.2 requires that the branch manager (or alternate) review the previous day's trading for unsuitable trades, leveraging and any</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>



Functional Area	Staff Findings	MFDA's Response	Staff Comments
		<p>other unusual trading activity. The Notice addresses situations involving an unsolicited order where: 1) an Approved Person has performed a suitability review; 2) the Approved Person has advised the client that the proposed transaction is unsuitable; and 3) the client wishes to proceed with the transaction despite the advice of the Approved Person.</p> <p>We note that MFDA Staff Notices set out staff's interpretation of how to comply with requirements under MFDA Rules and Policies. We will amend the language of the Notice to clarify that it is staff's interpretation that where the Approved Person knows the transaction is unsuitable before the trade is placed, it is consistent with the policy objective of the branch manager trade requirement in Policy 2 for the Approved Person to clear the order with</p>	

Functional Area	Staff Findings	MFDA's Response	Staff Comments
		<p>the branch manager/compliance officer before proceeding with the trade (rather than waiting for the transaction to be flagged or discovered in the next day's review).</p>	

#### IV. Appendix B – January 2015 oversight review

This appendix sets out the scope and findings of the targeted review completed in January 2015, by BCSC and OSC staff (together, the Reviewing Regulators), for the review period from July 1, 2012 to October 31, 2014.

##### Scope

The Reviewing Regulators determined, through an annual risk assessment of the MFDA conducted in 2014, that the areas of information technology and risk management were high risk and warranted a targeted review.

A key factor in assessing these as net high risk areas and choosing them for a targeted review was to update Reviewing Regulator staff's understanding of the effectiveness of identifiable controls in these areas. The results of the targeted review were then used to inform the 2015 risk assessment.

##### Findings

<b>Functional Area</b>	<b>Staff Findings</b>	<b>Priority</b>	<b>MFDA's Response</b>	<b>Staff Comments</b>
Risk management	<p><u>Internal departmental reviews</u></p> <p>Reviewing Regulator staff assessed a sample of departmental internal reviews against the extensive requirements of the written internal procedures, which are part of the MFDA's risk management processes, and found inconsistencies.</p> <p>The written procedures outline required standards that must be followed to ensure quality-control testing. Non-adherence to the standards may result in applicable deficiencies not being identified, escalated and resolved.</p>	Medium	We will review the requirements set out in the written procedures to ensure that they are consistent with the current risk-based approach we have adopted in conducting our departmental reviews.	Staff acknowledge the MFDA's response and have no further comment at this time.
Information technology	<p><u>Security access cards</u></p>	Medium	The quarterly reconciliations of security	Staff acknowledge the MFDA's

Functional Area	Staff Findings	Priority	MFDA's Response	Staff Comments
	<p>Adequate security access card reconciliations in the MFDA regional offices were not completed.</p> <p>Access to all MFDA premises must be effectively monitored to prevent unauthorized persons from gaining access to the premises and, potentially, to confidential information.</p>		<p>cards for the regional offices will be sent to head office for review upon completion.</p>	<p>response and have no further comment at this time.</p>
Information technology	<p><u>Priority resolution timeframes</u></p> <p>The priority resolution timeframes within the monthly IT Work Order Benchmark Report were inconsistent with the written Help Desk and Process Service Level Agreement procedure.</p> <p>IT Help Desk staff may rely on the written timeframes and inadvertently cause missed benchmarks to be recorded on the monthly report.</p>	Low	<p>The resolution timeframes within the monthly IT Work Order Benchmark Report and the settings within the Help Desk Work Order system were reconciled and now appear consistently throughout.</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>
Information technology	<p><u>Review of benchmarks</u></p> <p>Evidence of review of the monthly IT Work Order Benchmark Report was not maintained.</p> <p>Without a review, assigned benchmarks may not be met and remedial action may not be taken.</p>	Low	<p>Sign off by the Director, IT Operations, will evidence review of the monthly IT Work Order Benchmark Report. A quarterly summary of the monthly reports will be provided to the VP, Finance &amp; Administration upon the completion of each quarter.</p>	<p>Staff acknowledge the MFDA's response and have no further comment.</p>