

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

**Issued: September 15, 2017**

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## **I. Introduction**

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

The MFDA is recognized as an 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, 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 an SRO in Québec. The MFDA cooperates with the Autorité des marchés financiers in regulating MFDA member firms with operations and activities in Québec.

Staff of the ASC, BCSC, FCAA, MSC, NSSC and OSC (Staff) conducted the review jointly.

This report details the objectives, methodology, frame of reference, report format, scope, overall assessment, and findings of the review for the period from August 1, 2015 to January 31, 2017 (the review period).

### **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.

### **2. Methodology**

The Recognizing Regulators used a risk-based methodology to determine the scope of the review. On an annual basis, the Recognizing Regulators:

- assess the inherent risks of each functional area or key process based on:
  - reviews of MFDA documentation, including management self-assessments and risk assessments
  - information received from the MFDA in the ordinary course of oversight activities, including filings and discussions with MFDA staff
  - extent and prioritization of findings from the last oversight review
  - impact of significant events in or changes to markets and participants to a particular area
- evaluate known controls for each functional area

- consider relevant situational / external factors and the impact of enterprise wide risks on the MFDA as a whole or on multiple departments
- assign an initial overall risk score for each area
- discuss with the MFDA the effectiveness of other controls and processes that may be in place in specific functional areas
- assign an adjusted overall risk score for each area
- use the adjusted risk scores to determine the scope of the review

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

Staff last performed an oversight review of the MFDA in late fall of 2015<sup>1</sup>. Following that review, Staff issued and published a report on November 18, 2016 (the 2015 oversight review report), which noted a number of regulatory related findings, particularly in enforcement with two high priority findings and financial compliance with one high priority finding. The 2015 oversight review report included the MFDA's commitments and timelines to resolve the findings, which Staff reviewed and accepted.

As part of the risk assessment process, Staff followed up on the MFDA's progress in resolving the 2015 oversight review report findings. Staff also considered the following challenges faced by the MFDA, and the implications for the relevant functional areas and processes included in the review:

- *Stakeholder expectations*: As an SRO, the MFDA must fulfill its regulatory mandate to enhance investor protection and strengthen public confidence in the mutual fund industry. In achieving this objective, the MFDA must manage limited resources committed to regulating and enforcing existing standards of conduct on its members and approved persons, while meeting the needs and expectations of the investing public and broader financial community.
- *Changing regulations*: Changes in the investment industry also require the MFDA to focus resources on policy initiatives to interpret changes in securities regulation, and implement changes to internal processes and systems necessary to keep pace with the evolving regulatory environment.

### **4. Report format**

In keeping with a risk-based approach, this report focuses on functional areas or key processes with findings that require corrective action. 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**

Through the risk assessment process, including consideration of the status of the resolution of findings from the last oversight review and the challenging issues that may

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<sup>1</sup> The 2015 oversight review period was from July 1, 2012 to July 31, 2015.

affect the MFDA, Staff identified specific processes and activities<sup>2</sup> within the following above average risk areas for review<sup>3</sup>:

*Above average*

- Enforcement
- Financial compliance
- Policy

Also through the risk assessment process, Staff determined that the following moderate and low risk areas would not be in this review<sup>4</sup>:

*Moderate*

- Sales compliance
- Membership services
- Financial operations
- Risk management
- Information technology

*Low*

- Corporate governance

## 6. Priority of findings

Staff prioritized findings based on the following criteria:

**High** Staff raise an issue that, if unresolved, will result in the MFDA not meeting its mandate, or one or more of the terms and conditions of its recognition orders, or the applicable regulatory requirements. The MFDA must immediately put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to Staff. If necessary, compensating controls should be implemented before the finding is resolved. The MFDA must report regularly to Staff on its progress.

**Medium** Staff raise an issue that, if unresolved, has the potential to result in an inconsistency with the MFDA's mandate, or with one or more of the terms and conditions of its recognition orders, or with applicable regulatory requirements. The MFDA must put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to Staff. If necessary, compensating controls should be implemented before the finding is resolved. The MFDA must report regularly to Staff on its progress.

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

<sup>3</sup> No functional areas were determined to be categorized as high risk.

<sup>4</sup> The areas continue to be subject to oversight by the Recognizing Regulators through ongoing mandatory reporting by the MFDA as required by the recognition orders, as well as regularly scheduled and ad hoc meetings between the Recognizing Regulators and MFDA staff.

**Low** Staff identify an issue requiring improvement in the MFDA's processes or controls and are raising the issue for resolution by the MFDA's management.

## **7. Summary of findings and assessment**

The MFDA made significant progress in completing the action plans for the findings cited in the 2015 oversight review report as detailed in the *Fieldwork & findings section*.

In this review, Staff identified one medium priority finding in the Financial Compliance Department and one low priority finding in the Enforcement Department. There were no findings in the Policy Department. Staff expect the MFDA to resolve the findings, and Staff will monitor and follow up on the MFDA's progress in taking specific and timely corrective action on the findings.

Other than the findings noted, Staff did not identify concerns with the MFDA meeting the relevant terms and conditions of the Recognizing Regulators' recognition orders. Staff make no comments on the MFDA operations or activities that are outside the scope of the review.

## II. Fieldwork & findings

### A. Enforcement

T&C #8 of the recognition orders require the MFDA to discipline its members and their Approved Persons who violate MFDA rules and cooperate with the Recognizing Regulators to enforce applicable securities legislation. The Enforcement Department is responsible for enforcing compliance by MFDA members and Approved Persons by:

- performing a preliminary assessment of case files
- investigating complaints or referrals about possible regulatory misconduct
- bringing disciplinary action in cases of misconduct

MFDA enforcement staff are organized into the following groups:

- case assessment
- investigation
- litigation

The 2015 oversight review identified:

- two high priority findings regarding:
  - escalating signature falsification cases as appropriate
  - bringing cases against dealer members when warranted
- two medium priority findings regarding:
  - allocating adequate resources to enforcement functions
  - posting timely regulatory notes in the National Registration Database (NRD)
- one low priority cross-departmental finding relating to the review of member risk criteria

Given the significance of the risks underlying the 2015 findings and other risks considered in Staff's annual risk assessment of the MFDA, Staff focused on:

- the MFDA's progress in addressing the findings from the 2015 oversight review report noted above.
- the MFDA's tracking of limitation periods.

In fieldwork, Staff reviewed:

- enforcement caseload and staffing data
- departmental policies and procedures, including processes for identifying cases to be escalated for disciplinary action, enforcement penalties for cases involving signature falsification and pre-signed forms, and criteria for bringing cases against member firms as well as approved persons
- samples of case assessment, investigation, and litigation files to assess adequacy of action taken by MFDA
- the timeliness of regulatory notes in NRD
- management reports, including implementation of changes to facilitate

- tracking of limitation periods on case files
- minutes of the Escalation Review Committee meetings and related documentation
- the implementation of a scheduled review of the risk model

Staff interviewed the Senior Vice-President, Member Regulation – Enforcement, Enforcement Directors, and other staff.

Staff found that the MFDA adequately addressed the issues raised in the 2015 oversight review. In particular, the MFDA:

- commenced almost twice the number of signature falsification proceedings as were done during the 2015 oversight review period
- increased the penalties for signature falsification activity, and published guidance on supervising, investigating and internal disciplinary action regarding this activity
- opened more than twice the number of supervision cases against members as were done during the 2015 oversight review period. The MFDA enhanced its processes by developing an additional reporting tool and providing direction to enforcement staff on investigative procedures regarding member supervision
- significantly improved the timeliness of NRD postings. The MFDA implemented enhanced case tracking reports since the last oversight review. The MFDA also implemented, in April 2017, an additional step to check that MFDA staff opened a regulatory note on NRD, which should further reduce the error rate
- increased enforcement staff from 54 to 56 during the review period to address increased workload
- formalized an annual review of the risk model in its policies and procedures

Staff expect the MFDA to continue to assess the effectiveness of its internal enforcement processes and related metrics for achieving the MFDA’s mandate of investor protection and fulfilling its regulatory obligations. We acknowledge that the MFDA’s increased pursuit of disciplinary actions for signature falsification cases is consistent with Staff’s view that the falsification of any documents for any reason is unacceptable. Going forward, Staff expect the MFDA to continue to seek enhanced disciplinary penalties in signature falsification cases as stated in MFDA Bulletin #0066. Staff also expect the MFDA to continue to assess the adequacy of dealer member supervision in appropriate cases and to actively seek disciplinary actions against dealers, as warranted.

Staff identified one low priority finding regarding adequacy of documentation in case files as noted below.

**Finding: Adequacy of documentation in case files**

Staff reviewed a sample of enforcement case files relating to firms categorized as high



risk by the enforcement risk model. Staff acknowledge that within the documentation for each case file sampled, the MFDA identified and handled individual issues appropriately.

However, Staff note a lack of documentation in case files to demonstrate that:

- high risk firms are identified for a heightened review
- disciplinary history was considered in the decision-making process
- a holistic view of the member firm including a member’s compliance history was considered in the decision-making process

<p><b>Why this is Important / Risk Implication</b></p>	<p>Without documentation in a case file or other related documents, such as Escalation Review Committee minutes, it is not clear that MFDA staff had properly considered a firm’s high-risk ranking and/or prior compliance history in deciding case action. Without this confirmation, it is difficult to determine that enforcement actions were reasonable in the circumstances.</p>
<p><b>Priority</b></p>	<p><b>Low</b></p>
<p><b>Requirement</b></p>	<p>Please describe how the MFDA will resolve this finding.</p>
<p><b>MFDA’s Response</b></p>	<p>We agree that documenting our activity in this regard would be of assistance. We will be revising our procedures accordingly, including identifying the firm risk level in the file at the case assessment stage and documenting how the Member risk level and history of compliance was considered in formulating a recommendation in the case.</p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff acknowledge MFDA’s response and have no further comment.</p>

## **B. Financial compliance**

T&C #7 of the recognition orders require the MFDA to conduct periodic examinations of MFDA members and Approved Persons to ensure they comply with MFDA rules. The Financial Compliance Department is responsible for ensuring that members comply with prudential requirements.

Financial compliance staff are responsible for:

- reviewing member financial filings to ensure that members maintain and report adequate capital in accordance with MFDA rules
- conducting on-site financial compliance examinations
- reviewing member auditor working paper (AWP) files

The 2015 oversight review identified:

- one high priority finding regarding MFDA staff's failure to take timely follow-up action to ensure that the repeat finding was adequately resolved, prior to closing the examination file of a high risk dealer
- two medium priority findings regarding:
  - timeliness of AWP reviews and follow up on significant issues found in AWP reviews
  - adequacy of documentation to support issues resolution in examination files
- one low priority cross-departmental finding regarding the review of member risk criteria

Following the risk assessment, the 2017 oversight review principally focused on the MFDA's progress in addressing the findings from the 2015 oversight review report.

In fieldwork, Staff reviewed:

- the report on the MFDA's annual internal review of financial compliance examination files and management's responses to the results
- departmental policies and procedures, including the financial compliance program for examinations and the financial examiner reference manual
- guidance provided to financial compliance staff
- a sample of financial compliance examination files to confirm adequacy of staffing and supervision, documentation of escalation, and resolution of contentious issues prior to closure of the examination file
- changes to the scheduling of AWP reviews (Staff also tested a sample of AWP reviews resulting from the changes)
- the implementation of a scheduled review of the risk model

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

Staff found that the MFDA made adequate progress in addressing the findings from the

2015 oversight review. Since the last oversight review, the MFDA:

- maintained documentation of its review of member responses in the sampled examination files
- amended its processes and procedures to prioritize and improve timeliness of AWP reviews
- formalized an annual review of the risk model in its policies and procedures

Staff expect the MFDA to review new and amended internal financial compliance processes on an ongoing and timely basis to ensure that they are operating effectively, and revise as necessary.

Staff identified one medium priority finding regarding a lack of policies and procedures for handling repeat deficiencies as noted below.

**Finding: Lack of written guidance for handling repeat deficiencies**

MFDA financial compliance staff are expected to exercise judgment in determining the appropriate resolution of repeat deficiencies in MFDA financial compliance examination reports issued to members. However, there is no specific written guidance for MFDA staff to assist them in assessing the nature and significance of repeat deficiencies and in determining an appropriate timeline for resolution by the members.

In one financial compliance examination file reviewed by Staff, the financial compliance examination report noted several repeat deficiencies that had also been raised in prior examination reports. In this case, financial compliance staff accepted the member’s responses and did not require the member to provide evidence of resolution of the repeated deficiencies. In Staff’s view, written guidance, in addition to professional judgment, is necessary for the consistent classification and resolution of repeat deficiencies. In addition, guidance concerning the follow-up work required based on the significance of each finding and adequacy of the member’s response is also necessary.

<b>Why this is Important / Risk Implication</b>	A lack of specific written guidance concerning the nature, classification, significance and resolution of repeat deficiencies may result in inconsistent or inadequate outcomes, and could undermine the effectiveness of the regulatory process and increase the risk to the investing public.
<b>Priority</b>	<b>Medium</b>
<b>Requirement</b>	Please describe the action plan that MFDA will take to address this finding, including a timeline for resolution.
<b>MFDA’s Response</b>	We agree that providing additional written guidance, relating to

	<p>the nature / significance of repeat deficiencies and the related expected timeline for resolution by the Member, could enhance consistency going forward. We will make changes to our policies and procedures to address the finding by September 30, 2017.</p>
<p><b>Staff Comments and Follow-up</b></p>	<p>Staff are encouraged that the MFDA will make changes to their policies and procedures to guide MFDA staff in assessing the nature and significance of repeat deficiencies and in determining an appropriate timeline for resolution by the member.</p> <p>Staff expect the MFDA to:</p> <ul style="list-style-type: none"> <li>• have the new process in place by September 30, 2017</li> <li>• monitor and report on the effectiveness of the enhancements by February 28, 2018</li> </ul>

## C. Policy

T&C #10 of the recognition orders require 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 Policy Department is responsible for:

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

The 2015 oversight review identified:

- a medium priority finding about internal processes for delegating decision making to staff
- a low priority finding about clarity of regulatory implications of staff notices

Based on Staff's annual risk assessment of the MFDA, Staff reviewed the MFDA's progress in addressing findings from the 2015 oversight review.

In fieldwork, Staff reviewed:

- a sampling of staff notices to determine if they contained prescriptive language that was not supported by a rule
- departmental policies and procedures, including guidance for the delegation of authority
- delegation of authority documents

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

Staff found that the MFDA addressed the issues raised in the 2015 oversight review. The MFDA enhanced their internal documentation procedures to provide greater clarity on the scope of authority of individuals authorized to act for the Corporation in accordance with MFDA Rules and By-law.

### **Finding**

There were no findings noted for the area.