

**INDUSTRY REPORT**  
**SCHOLARSHIP PLAN DEALERS**  
Compliance Team, Capital Markets  
Ontario Securities Commission

# Ontario Securities Commission Scholarship Plan Dealers – Industry Report

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## **Executive Summary**

The Canadian Securities Administrators performed a National Compliance Review (NCR) of scholarship plan dealers in 2003. The purpose of the NCR was to assess the compliance of scholarship plan dealers with applicable provincial securities legislation and to enhance information sharing of regulatory issues among the provincial regulators.

The Compliance team of the Capital Markets branch of the Ontario Securities Commission (Commission) has prepared this report to provide guidance to scholarship plan dealers in complying with Ontario securities law. Although the report focuses on staff's findings, we feel they are also representative of those found during the NCR by the other participating jurisdictions. Due to the numerous and varying findings across the different dealers, we have focused our report on the deficiencies that were most commonly identified and those that were considered to be the most serious.

### *Participating Provinces*

The NCR was conducted by the securities regulators in British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario and Prince Edward Island. The Bureau des Services Financiers in Quebec also participated in the review since it is responsible for the oversight of dealers in that province. Each participating jurisdiction reviewed certain branch operations in their province while Ontario also reviewed the head office operations. In total, five scholarship plan dealers were reviewed as part of the 2003 NCR.

### *Scope of the Review*

The scope of the review included the following areas:

- Capital Requirements
- Contractual Agreements and other Business Arrangements
- Compliance and Supervision
- Opening of New Accounts and Maintenance of Know Your Client (KYC) Information
- Scholarship Plan Enrolment Process
- Books and Records
- Sales Practices
- Sales Representative Interviews

Within each of the above areas, we performed testing to evaluate compliance with applicable securities legislation and to identify weaknesses in the practices of the dealers. Compliance examination reports outlining the deficiencies noted were forwarded to each dealer for a written response. Each jurisdiction is dealing separately with their respective reports and will determine what further action, if any, will be required to ensure that the deficiencies are adequately addressed and rectified. Ongoing Commission initiatives are described in the next section of this report.

### *Overall Comments*

Numerous deficiencies were identified as a result of the NCR. In many cases, we identified issues which had been previously brought to the attention of the dealers by other securities regulators. For example, the Alberta Securities Commission conducted both initial and follow-up reviews of scholarship plan dealers and issued an industry report on common deficiencies in October 2002. Many of the deficiencies outlined in that report were still prevalent during the 2003 NCR indicating that the industry did not take appropriate action to remedy these concerns.

## **Commission Initiatives**

The short term priority of staff is to deal immediately with the responses received from the dealers on the deficiencies noted during the NCR and determine whether appropriate action has been taken to ensure resolution of the issues identified and discussed in this report. We require the dealers to make the necessary changes to their operations to address these deficiencies and to establish adequate policies and procedures for ongoing compliance. We conducted focused follow-up compliance reviews in March and April 2004 after giving the dealers adequate time to make the changes that were represented in their responses. We compared the findings from the follow-up review to the initial findings to assess whether adequate measures had been taken in the intervening period. We noted some improvements in all of the dealers reviewed, however, numerous deficiencies continued to be outstanding. Due to the repeated non-compliance, more stringent measures are being taken and varying terms and conditions have been imposed on the registration of these dealers. The Compliance team will monitor the progression of each dealer in adequately addressing all deficiencies found in both the initial and follow-up reviews before these terms and conditions are removed.

As more of a medium term initiative, Commission staff resources have been dedicated to rulemaking in respect of scholarship plan dealers. While it is too early to determine specifically the nature and breadth of such rules and to describe them in this report, it is clear from the nature and the volume of the deficiencies noted during both the NCR and the focused follow-up reviews that more specific rules are required. In the interim, each dealer should review this report and use it as a self-assessment tool for enhanced compliance with Ontario securities law.

## **Major Findings**

Outlined below are the major findings from staff's review of scholarship plan dealers. These findings are presented on an aggregate basis and in some cases, include examples that support the findings. The examples provided have been consolidated based on our findings across all the dealer firms and do not all necessarily apply to each dealer. We have also provided suggested practices to assist scholarship plan dealers in improving their existing practices and in strengthening their compliance environment. The suggested practices encompass both requirements under existing legislation and recommended best practices but are not meant to be an exhaustive list of the practices and procedures that could be incorporated by the dealers to mitigate the existence of the weaknesses identified.

## **1.0 Compliance and Supervision**

### **1.1 Role of the Compliance Officer**

Subsection 1.3(1) of OSC Rule 31-505 requires every registered dealer to designate a registered partner or officer as the compliance officer who is responsible for discharging the obligations of the registered dealer under Ontario securities law. We noted a number of instances where the designated compliance officers did not ensure that the dealers discharged their obligations under Ontario securities law as follows:

- The compliance officer is responsible for supervising the branch manager's conduct over the review of new accounts and the supervision of client trades and advice. However, there is no review of the branch manager's activities by the compliance officer to ensure that these functions are being carried out adequately. (see Role of the Branch Manager in Point 1.2)
- There is no formal reporting requirement from the branch managers to the compliance officer and limited contact, if any, between the parties.
- The compliance officer does not periodically visit or perform supervisory reviews of the branches or sub-branches to ensure that both Ontario securities law and internal policies and procedures are being adhered to.
- The compliance officer does not review the enrolment applications and transaction orders initiated by the branch managers.

Many of the deficiencies identified during the NCR and reported on throughout this report are directly linked to the weaknesses in the compliance structure and the role of the compliance officer. These deficiencies will be dealt with separately in other areas of the report.

#### *Suggested Practices*

- The compliance officer should develop a formal branch review program and perform branch reviews on a regular basis. All of the issues identified should be communicated to the branch manager and be followed-up and resolved in a timely manner.
- A sample of transactions and enrolment applications from each branch should be reviewed to ensure that all sign offs and reviews have taken place at the branch level.
- The compliance officer should be responsible for reviewing the branch managers' activities, including trades processed for their clients.
- Internal policies and procedures should be communicated to branch managers and sales representatives on a regular basis to ensure that they are understood and are being followed.

### **1.2 Role of the Branch Manager**

Subsection 1.4(1) of OSC Rule 31-505 states that if a registered dealer operates a branch office, the dealer must designate a registered salesperson, officer or partner as the branch manager for the branch. Subsection 1.4(2) of OSC Rule 31-505 further states that the

branch manager is responsible for functions such as opening new accounts, supervising trades made for or with each client and supervising advice provided to each client. In addition, the branch manager shall report directly to the compliance officer.

We noted a number of instances where the branch managers did not adequately or effectively supervise their sales representatives:

- Some branch managers are supervising a large group of sales representatives that render the supervision inadequate and ineffective.
- There was a lack of review of trade transactions at the branch level (see Point 1.3).
- Some branch managers allowed enrolment applications and transaction forms to be submitted to head office for processing without any branch manager review or to be reviewed by administrative personnel at the branch location.
- There was inadequate collection and documentation of KYC and suitability information and review thereof (see Point 2.1).
- Several branch managers told us that they did not have a direct supervisor.
- There is limited interaction between the sales representatives and the branch manager, and the branch manager and the compliance officer.
- A limited number of sales representatives indicated that they act without the advice of their branch manager in dealing with client complaints.

#### *Suggested Practices*

- Limit the number of sales representatives to be supervised by one branch manager to a manageable and reasonable number, taking into account the other responsibilities of the branch manager, the geographic location of the representatives that are being supervised and whether the sales representatives can be visited on a periodic basis to evaluate their sales practices and their dealings with clients.
- Branch managers should review all new enrolment applications and should ensure that trade transactions are reviewed prior to processing at head office. If these duties are delegated to another individual at the branch, that individual should have adequate proficiency and the branch manager is responsible for the oversight of such duties.
- Client files should be reviewed regularly to ensure there is adequate and current KYC information on file.
- Branch managers should communicate regularly with the sales representatives at the branch and reiterate that they should be notified of client complaints and any other issues requiring branch manager review and approval, such as marketing and other sales endeavors.

### **1.3 Trade Suitability Review**

The branch manager is responsible for opening new accounts, supervising trades made for each client and supervising advice provided to each client as per subsection 1.4(2) of OSC Rule 31-505. We noted significant weaknesses in the review for trade suitability as follows:

- Most sales representatives had no branch manager reviewing their trades and enrolment application forms before submitting them to head office for processing.
- There was no evidence of review of the enrolment forms at the head office level in the absence of branch level review.
- In some cases, the forms were reviewed by administrative personnel for completeness. These individuals lack the proficiency and knowledge to assess suitability of the trade for clients.
- There was no evidence that the branch managers' trades were reviewed or that branch managers themselves were reviewing sales representatives' trades for suitability.
- Some sales representatives indicated that the overall financial situation of clients was not always considered when assessing suitability or affordability of the plan. In other cases, sales representatives indicated that irrelevant criteria such as home surroundings were used to assess suitability.
- There were suitability concerns on a sample of enrolment applications that we reviewed relating to the value of the monthly deposit relative to the clients' income and KYC information provided.
- Certain plans had a high number of terminations or cancellations indicating that these plans were potentially unsuitable for clients at the onset. However, there is no review of the terminations by the compliance officer to determine the reasons.

#### *Suggested Practices*

- All trades and enrolment applications must be reviewed by the branch manager at the branch, prior to submitting the forms to head office.
- There should be evidence of the review by the branch manager in the form of initials and the date of the review. Similarly, there should be an individual responsible for reviewing the branch managers' activities and there should be evidence of review and approval of their trades.
- Guidelines should be developed and communicated to sales representatives on the affordability of plans, taking into consideration the income of the household and the proposed monthly contribution. Any deviations from the guidelines should be approved by the branch manager.
- The branch manager and/or the compliance officer should conduct reviews on a regular basis to identify unfavorable trends. For example, sales representatives with a high number of terminations or with a high volume of leveraged clients should be questioned about the suitability of the plan for their clients.

## **2.0 Opening of New Accounts and Maintenance of KYC Information**

### **2.1 Collection and Update of KYC and Suitability Information**

Section 1.5 of OSC Rule 31-505 requires registrants to make enquiries about each of their clients as are appropriate to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase of a security for the client.

We noted the following deficiencies with respect to the collection, documentation and review of KYC and suitability information:

- We noted that a large portion of the enrolment applications that we sampled contained incomplete or missing KYC information, thereby impeding the ability of the dealers to assess whether a plan is affordable and suitable for a client.
- There was no evidence of review and approval of the new account opening forms.
- There is no process in place to update KYC information to reflect any material changes to clients' circumstances.
- In one instance, training materials and sales representative proficiency exams did not adequately address KYC and suitability rules.
- Enrolment applications did not require all the appropriate KYC information, such as the number of dependents of the subscribers and whether leveraging is being used to purchase units in scholarship plans.

#### *Suggested Practices*

- Complete KYC information must be collected for all clients prior to any trade execution, including such information as the client's identity, age, credit worthiness, occupation, annual income, net worth, investment objectives, investment knowledge, investment time frame, risk tolerance and source of funds.
- KYC information should be periodically updated.
- Clients must sign the KYC information form.
- The enrolment application form must be reviewed and approved by the branch manager.
- If possible, KYC information should be maintained in an electronic format which can be used to generate exception reports.
- Maintain a pending file when a KYC form is incomplete.
- The pending file should be cleared on a timely basis.

## **2.2 Inadequate Disclosure**

There are many fees associated with the purchase of scholarship plan units, however, we noted a lack of disclosure and clarity to clients on the nature of these fees and their implications on the plans' returns. Section 1.2 of OSC Rule 31-505 requires every dealer to establish and enforce written procedures for dealing with clients that conform to prudent business practice and enable the dealer to serve its clients adequately. Furthermore, adequate disclosure ensures that the registrant is dealing fairly, honestly and in good faith with its clients as required under section 2.1 of OSC Rule 31-505.

The following weaknesses were noted with respect to the disclosure provided to clients:

- Sales representatives lacked adequate knowledge of the product being sold to clients, and its associated costs (see Point 8.1).
- Enrolment fees were misrepresented in some cases, leading clients to believe that the potential for loss was nil.



- Enrolment fees and the related consequences of terminations were not always discussed with clients.
- The 60 day grace period was not always explained to clients.
- In some cases, there was no mention of other types of fees incurred by the plans.

#### *Suggested Practices*

- Ensure that sales representatives have sufficient knowledge of the product, including all fees, prior to the commencement of selling units to clients.
- A copy of the most recent prospectus should be provided to all clients and sales representatives should indicate where the fees are disclosed therein.
- The implications of terminations or plan cancellations, both within 60 days and thereafter, should be discussed with clients.
- Guidelines, such as a checklist, could be developed and incorporated into the account opening procedures. The checklist would outline each type of fee and the client could initial each one after it has been discussed and understood.

### **3.0 Registration Requirements**

#### **3.1 Unregistered Activities**

The assets of the scholarship plan must be managed by a registered adviser who has the adequate proficiency to perform this function. Paragraph 25(1)(c) of the Act states that no person shall act as an adviser unless the person is registered as an adviser. We noted two instances where plan assets were being managed, in part, by non-registered individuals as follows:

- Investment decisions were being made and all trade activities were being approved by these non-registered individuals.
- The individuals were responsible for reviewing the portfolios to ensure conformance with the strategy.
- The individuals provided analysis and outlook for the investment market and were designated as the key persons to communicate with their investment dealers in facilitating trade execution.

All dealers should ensure that the persons or companies that are acting as advisers over their plan assets are properly registered and have the proficiency to manage the portfolios as required. In addition, the plans' advisers should be disclosed in the prospectus to ensure that full, true and plain disclosure of all material facts is included therein.

#### **3.2 Registration of Branches and Sub-branches**

Each dealer operates a number of branches and sub-branches where sales representatives meet with clients to conduct business and maintain client files. We did not have any record of these branches and sub-branches being registered with the Commission or a list of the individuals designated to be the branch manager at these locations as required under section 3.2 of Multilateral Instrument 33-109.

Every registered dealer must notify the Commission within five business days of the opening or closing of any branch office in Ontario and, in the case of the opening of any branch office in Ontario, the name and address of the person in charge of that office.

### **3.3 Statement of Policies**

Section 223 of the Regulation requires scholarship plan dealers to prepare and file a statement of policies with the Commission as well as provide a copy to their clients. This statement should outline the activities of the dealer in respect of related or connected issuers. The scholarship plans distributed by the dealers are considered to be related and/or connected issuers and must be disclosed in their statement of policies.

We noted that a statement of policies was not prepared and a copy was not filed with the Commission or provided to clients.

#### *Suggested practices*

- A current statement of policies must be prepared and filed with the Commission.
- If a significant change occurs, a revised statement of policies must be filed with the Commission and distributed to all clients.
- A copy of the statement of policies must be provided to all clients.
- The statement of policies must include a complete listing of related issuers along with a concise description of the nature of the relationship with each of the related issuers.
- The statement must include the disclosure required in Regulation 223(1)(d).

Many dealers were opposed to preparing a statement of policies as some of the information required therein is already contained in the prospectus. However, unless an exemption from this requirement is obtained under section 233 of the Regulation, these dealers must comply with the requirements of Regulation 223.

## **4.0 Sales Practices**

### **4.1 Holding Out**

It is the dealer's responsibility to ensure that clients understand with which legal entity they are dealing. Furthermore, a clear distinction must be drawn between the foundation, which is the sponsor of the plan, and the dealer who is distributing it as required under National Policy Statement 15. Staff noted the following issues related to holding out:

- Some sales representatives indicated to clients that they work for the foundation, a not-for-profit entity, rather than for the dealer which is a for-profit organization.
- Training manuals and other reference tools used by the sales representatives encourage them to hold themselves out as working for the foundation and to inform clients that they are not selling anything.

### *Suggested Practices*

- All clients must be informed that the sales representatives are acting on behalf of a dealer and will be compensated for the sale of units of scholarship plans.
- Training materials and client scripts should exclude misleading representations.
- The full legal name of the dealer must be used on all correspondence with clients, on business cards and in marketing materials to make it clear to clients with which entity they are dealing.
- The dealer name and the foundation name should not be so similar as to cause confusion among clients.

## **4.2 Business Cards, Branch Signage and Telephone Greetings**

The use of names other than the full legal name of the dealer may be misleading to clients. In addition, paragraph 25(1)(a) of the Act states that no person or company may act as a dealer unless registered. We reviewed a sample of business cards, branch signage and telephone greetings and noted the following deficiencies which may cause confusion for clients:

- A number of sales representatives were using outdated business cards.
- Some business cards did not include the name of the dealer or contained the names of the sales representatives' non-registered companies, rather than that of the dealer.
- Branches did not display the registered dealer name on their premises or use it in their telephone greetings.
- Business cards contained inappropriate and misleading titles.
- Business cards had the name of the foundation, not the dealer.

### *Suggested Practices*

- Business card orders should be handled centrally by head office to ensure all business cards are consistent, contain the full legal name of the dealer only and do not contain misleading or inappropriate titles.
- All branches should display the legal name of the dealer.

## **4.3 Misleading Marketing**

Section 2.1 of OSC Rule 31-505 states that all dealers must deal fairly, honestly, and in good faith with their clients. Accordingly, all marketing materials should contain information that is accurate and should not make representations that are misleading to clients.

We noted misleading information in materials prepared by both head office and sales representatives as follows:

- Outdated information was used in pamphlets and brochures, such as the value of assets under management and the total amount returned to subscribers since inception.

- Actual rates of return provided in the marketing materials did not contain adequate disclosure regarding the assumptions used and whether the returns are gross or net of fees.
- Within the same dealer firm, there was no consistent methodology for calculating rates of return. For example, rates of return were calculated using creative calculations to make the returns appear higher, or were based on selected returns for only some periods, or were grossed up from net returns using estimates of fees paid rather than actual fees paid by clients.
- Projected rates of return were not reflective of recent performance of the plan, or were based on inflated percentages for assumed interest rates.
- Marketing materials claimed “superior returns”, “excellent rate of return”, “earns the highest income” and “exceptional returns” without any support to substantiate these claims.
- The full legal name of the dealer was not always used in marketing materials or was not used with the same prominence as the foundation name, which may cause client confusion about the entity with which they are dealing.
- The products were represented as “risk-free”, “guaranteed”, “government insured”, “safest funding methods”, “fully protected” and overall, as bearing no risk to clients.
- Some materials indicated that the dealer was a not-for-profit organization.
- Materials indicated that the security regulators had endorsed the product. Others included letters from government agencies and Commission registration letters which may mislead clients to believe that they are government or Commission endorsed.
- Inconsistent information was contained within the prospectus and the marketing materials.
- Materials claimed that only guaranteed securities were invested in by the plan, however, other types of non-guaranteed securities were also purchased for the plan.
- The government’s Canada Education Savings Grant program has a limit of \$400 per year, however, materials represented that the government would add 20% to the plan each year. No mention of the dollar limit was included.

Overall, many more instances of misleading information were noted in the materials we reviewed than those mentioned above.

#### *Suggested Practices*

- Establish and enforce procedures with respect to the preparation, review and approval of marketing materials.
- All marketing materials should be reviewed and approved by someone independent of their preparation.
- Establish guidelines on the preparation of performance data and apply them consistently from period to period.
- Rates of return should be accompanied by adequate disclosure which is clear and easily understood by clients. At a minimum, this would include the

assumptions used, the effects of enhancement factors due to plan forfeitures and other non-market related conditions, and the methodology used.

- Materials should not imply that Commission staff has in any way passed upon the financial standing, fitness or conduct of the dealer or upon the merits of the product being offered.
- Marketing materials should be regularly updated to ensure all information is complete and accurate and not misleading to clients.
- All claims made within the marketing materials should be adequately supported.

## **5.0 Contractual Agreements and Business Arrangements**

### **5.1 Sales Representative Agreements**

Subsection 1(1) of the Act defines a salesperson as an individual who is employed by a dealer for the purpose of making trades in securities on behalf of the dealer. Sales representatives are acting on behalf of a dealer and this should be reflected in their contracts with their respective dealer. Overall, we felt that the agreements signed by sales representatives of the dealers did not adequately reflect the responsibilities of the sales representatives or their relationship with the dealers. The following weaknesses were noted as a result of our review of these agreements:

- Agreements were between the sales representative and the branch, or the sales representative and the branch manager and not between the sales representative and the dealer.
- The agreements indicated that sales representatives were acting on behalf of the branch manager.
- The agreements did not define the responsibilities of each party to clients.
- The agreements did not outline which party has supervisory responsibilities.
- The agreements limited the liability of the dealers for the misrepresentations of their sales representatives.

#### *Suggested Practices*

- Agreements must be between the sales representative and the dealer.
- The agreements should clearly indicate that the securities related business is that of the dealer, and not the sales representative or the branch manager.
- The agreements should clearly outline the responsibilities of both the dealer and the sales representative, including those over the supervisory functions.
- The agreements should make it clear that the dealer is liable for the actions of its sales representatives.

### **5.2 Branch Manager Agreements**

We noted similar issues as those indicated above when we reviewed the branch managers' agreements with the dealers. Specifically, we noted the following deficiencies:

- There was inadequate detail regarding the branch manager's responsibility to supervise the activities of the sales representatives at the branch.
- Responsibilities were assigned to the branch manager that we think are the primary responsibility of the dealer. For example, the payment of commissions, the registration of sales representatives and the recruitment and training of sales representatives were allocated to the branch manager by the dealer.
- The agreements limited the liability of the dealers for the misrepresentations of their branch managers.

#### *Suggested Practices*

- The agreements should include the responsibilities of the branch manager to approve the opening of new accounts, to supervise trades made for or with each client, and to supervise the advice provided to each client.
- The relationship between the branch manager and the dealer must be structured as that of an agent or employee of the dealer.
- The agreements should reflect that the securities related business is that of the dealer, not the branch manager. Accordingly, the branch manager may assist the dealer with certain functions, however, the dealer is ultimately responsible for the registration, training and compensation of its sales representatives.
- The agreements should not limit the liability of the dealer for the actions or misrepresentations of its branch managers.

### **5.3 Business Arrangements**

Section 1.2 of OSC Rule 31-505 requires that every registered dealer establish and enforce written procedures that conform to prudent business practice. Accordingly, business arrangements with other entities should be approved by an individual with adequate authority and should be properly documented. We discussed business arrangements with both the dealers and their sales representatives and noted the following issues:

- Some sales representatives entered into arrangements with other entities without the knowledge of the dealer or the branch manager.
- Arrangements were entered into with individuals or companies that are not registered to trade in securities of scholarship plans, however, the arrangements indicated that these individuals or companies would be performing acts in the furtherance of a trade.
- Commissions were paid by sales representatives to the other parties in their business arrangements who are not registered.
- The terms of the business arrangements were not always in writing.
- The dealer's letterhead was used on client's statements for units sold by the other party dealer in the business arrangement.
- Commissions were paid to the other parties' sales representatives directly, rather than to the firm itself. As such, commissions were recorded off the books of the other entities.

### *Suggested Practices*

- All business arrangements should be approved in writing by head office.
- If arrangements with other parties include acts in the furtherance of a trade, the other entities should be properly registered for those types of trades.
- Commissions should be paid by head office directly to the other party, not to its sales representatives.
- The terms of the business arrangement should be clearly documented.
- The other entities' branch managers or compliance officers should review the trades of their sales representatives and ensure that these trades are properly recorded in their books and records. Similarly, the sales commissions should be recorded on the books of the other parties.
- The dealer's letterhead should only be used on client statements of its own clients.

## **6.0 Capital Requirements**

### **6.1 Capital Calculations**

Subsection 113(3), paragraph 10 of the Regulation requires that each registrant prepare a monthly calculation of minimum free capital, adjusted liabilities and capital required (capital calculation) within a reasonable period of time after each month end. The capital calculation is to be prepared based on monthly financial statements prepared in accordance with generally accepted accounting principles. All market participants are required to inform the Commission immediately should they become capital deficient and are required to rectify the capital deficiency within 48 hours.

During our reviews, we observed the following:

- Capital calculations were not always prepared or were not prepared on a timely basis and, therefore, monitoring of the firm's capital was not done.
- There was no evidence that a review of the calculation was performed by someone other than the preparer.
- The calculation of adjusted liabilities was incorrect.

### *Suggested practices*

- Capital calculations must be performed on a monthly basis and within a reasonable period of time after month end.
- Copies of the capital calculations should be maintained for purposes of an audit trail.
- A person other than the preparer should review the capital calculations to ensure that they are accurate.
- Evidence of the review should be documented.
- The Commission should be informed immediately should the dealer's capital position become deficient.

## **7.0 Books and Records**

### **7.1 Inadequate Books and Records**

Section 113 of the Regulation requires that registered dealers maintain books and records necessary to properly record their business transactions and financial affairs.

During our reviews, we observed the following:

- The dealer did not maintain a trade blotter or the blotter maintained was incomplete.
- Client statements of account were not delivered to clients on a monthly basis.
- Client statements of account did not include all necessary information such as the price per unit or units purchased to date.
- Client statements of account contained misleading information.
- The dealer did not send trade confirmations to its clients, rather it relied on the foundation to do so.
- The trade confirmation was incomplete.

#### *Suggested practices*

A list of books and records that dealers are required to maintain is contained in subsection 113(3) of the Regulation. In the absence of any exemptive relief, client statements of account should be delivered to clients on a monthly basis.

### **7.2 Policies and Procedures**

Section 1.2 of OSC Rule 31-505 states that every dealer should develop and enforce written procedures for dealing with clients that conform to prudent business practice and enable it to serve its clients adequately. The policies and procedures should be in sufficient detail, be updated on a periodic basis and be made available to all relevant staff. In addition, the relevant regulatory requirements should be outlined in the policies and procedures. We feel that written policies and procedures contribute to an effective compliance environment.

During our reviews, we observed the following:

- The dealer did not have a documented policies and procedures manual.
- The policies and procedures were not sufficiently detailed and/or did not contain procedures covering all major areas of the business.
- The actual practices of the dealer were not consistent with the documented procedures.
- The documented procedures were not being adhered to by the dealer's sales representatives and were not adequately enforced by the dealer.

#### *Suggested practices*

Each dealer should establish and enforce a written policies and procedures manual that is sufficiently detailed, up to date, and which covers all relevant areas of its business. At a minimum, the following list of topics should be considered for inclusion in the documented policies and procedures:



## **Trading**

- Monitoring and resolving cancelled and/or rejected trade orders, including the individuals responsible for such activities.
- Guidelines on trade suitability review.
- Procedures over the preparation and delivery of trade confirmations, including procedures to ensure accuracy and completeness of information prior to delivery.

## **New Accounts, KYC and Suitability Information**

- Collection, documentation and timely updating of KYC and suitability information for clients.
- Guidelines on how account application forms are to be completed, reviewed and approved.
- Specify the individual who is responsible for approving new client accounts.
- List the criteria to be used for approving new accounts.
- Specify the timing for approving new accounts.
- Guidelines on when transfers-in are suitable for clients.
- Requirement to obtain information regarding whether a client is using leverage to purchase the securities.
- Requirement to provide leverage disclosure document to clients and obtain their signature.

## **Administration**

- Handling of client complaints and maintenance of a log of complaints.
- Procedures over the preparation and delivery of client statements of account, including procedures to ensure accuracy and completeness of information prior to delivery.

## **Marketing**

- Ensuring adequate disclosure and adherence to applicable legislative requirements.
- Ensuring the exclusion of false or misleading information.
- Procedures over the review and approval of marketing material, including websites.
- Guidelines over the preparation and presentation of performance results.
- Procedures over the use of draw boxes.
- Procedures over the distribution of marketing materials.

## **Other Employment**

- Guidelines over what is acceptable as other employment and monitoring of conflicts of interest.

## **Financial Condition**

- Preparation, review and monitoring of monthly capital calculations.

## **Referral and Other Business Arrangements**

- Procedures over the review, acceptance and monitoring of arrangements with other parties.

## **Money Laundering Prevention**

- Definition of “money laundering” and examples of suspicious transactions.
- Handling of prescribed and suspicious transactions.
- Procedures to report prescribed and suspicious transactions to the Financial Transactions and Reports Analysis Centre of Canada.
- Documenting the records which should be maintained under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act and Regulations*.
- Establishing a compliance regime and employee training at the Registrant to ensure it meets its obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act and Regulations*.
- Requirements to maintain a large cash transaction record.

## **8.0 Sales Representatives**

### **8.1 Training of Sales Representatives**

The training provided to sales representatives varied greatly between dealers and also, between different branches of the same dealer. In many instances, the training of sales representatives was carried out by the branch manager or another sales representative, with little or no involvement by head office. This is consistent with the inappropriate structure adopted by many dealers where the branches are acting as autonomous business units with inadequate supervision by head office.

A strong training program for sales representatives, both at the onset of registration and on an ongoing basis, contributes greatly to a more effective compliance environment. Every dealer is responsible for the supervision of its sales representatives, partners and officers, including ensuring that they are properly trained.

The following weaknesses were noted regarding the training of sales representatives:

- The current proficiency exams do not adequately address compliance issues such as KYC and suitability rules.
- Sales representatives were allowed to complete the proficiency exams with the assistance of others.
- Sales representatives who transferred from another dealer were not required to write the proficiency exam at their new dealer, even though the exam contains materials specific to the new dealer’s product.
- Mandatory training was not being completed by all sales representatives and its completion was not being enforced by the dealer.
- Sales representatives were not aware of training courses being offered.
- Training materials were inadequate in areas dealing with regulatory requirements.
- Training materials encouraged high-pressure sales tactics.

- Training materials indicated that the products were approved by the Commission, which is misleading since no approval has been made by the Commission.

#### *Suggested practices*

- Head office should develop detailed training procedures and materials and ensure that they are distributed to all branches and used in the training of all sales representatives.
- Attendance at training should be monitored to ensure all sales representatives have attended mandatory sessions.
- Proficiency exams should be completed by all sales representatives prior to any dealings with clients.
- The administration of the proficiency exams and the passing requirements should be rigorous and consistent among all branches.
- The proficiency exam should be challenging and also address regulatory requirements, not just questions on product knowledge and sales techniques.
- Training should be provided on an ongoing basis to remind sales representatives of their duties and responsibilities.

## **RESP Dealers Association**

The RESP Dealers Association of Canada (“Association”) was formed in 1999 to represent the group plan distributors of registered education savings plans. Members of the Association have taken steps to create standards and uniformity in the industry. For example, a code of sales practices was developed and the Association is also working towards the development of a more in-depth proficiency exam.

We consider these to be positive steps towards streamlining the practices of the scholarship plan dealers in Ontario. However, further measures need to be taken by the dealers to increase the awareness of its sales representatives and branch managers in regards to the Association and its initiatives for enhanced compliance.

### **Contact Information**

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