

July 20, 2004

C/O Secretary to the Commission
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario
M5H 3S8

Attention: Ms. Antoinette Leung

Dear Ms. Leung,

Re: OSC Staff Notice 31-712 – Mutual Fund Dealers Business Arrangements, Issues Paper of the Ontario Securities Commission (June 2004)

Please accept our apologies for the lateness of our response. As you are aware, many of the questions are extremely difficult to respond to and there are no quick and clear cut solutions. Having said that, we thank you for the opportunity to respond and to take part in the industry discussion with the OSC in August.

Our responses to the questions are attached and if you have any questions or need to discuss them further, please do not hesitate to contact me.

Yours truly,

Mary-Lou Rice
Senior Vice President
M.R.S. Inc.
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Copy: Elizabeth King, Assistant Vice President, Legal

Summary of Questions and Response from M.R.S. Inc. ("MRSI")

1. Current Industry Trends

1. Do you agree with the description of current industry trends? Are you aware of any other similar changes?

Response:

We agree with the current industry trends as described in the OSC Issues Paper dated June 2004. As investors become more and more sophisticated, they are increasingly seeking to diversify their registered plan portfolios with non-mutual fund securities. The increase in the number of people investing in the stock market has been reflected in a number of statistics that have recently been released. This does not mean however, that this is widespread by any means. In fact, MRSI's experience as a large scale carrying dealer for other mutual fund dealers, has been that only 9% of our registered plan accounts contain equities and non-exempt fixed income securities ("non-exempt securities"). Investors are looking to diversify their registered plan portfolios with non-exempt securities or contribute shares that they have received through stock option plans or employee share purchase plans at their work place. They wish to do so in their registered plan held at a trusted mutual fund dealer and advisor that they and/or their families have been dealing with for many years. Obviously, one account, and therefore one stop shopping is advantageous to the investor, possibly in terms of cost but certainly in terms of foreign content management, and reduced paper. The mutual fund dealers, knowing that they are not licensed to trade in these types of securities, have formed relationships with investment dealers in order to meet their client needs.

Another trend that we have seen is that a mutual fund advisor often acquires a new client from an Investment Dealer and the client's portfolio already contains non-mutual fund securities. Our transfer records clearly reflect substantial account transfer activity going both ways between IDA members and MFDA members. In situations where an IDA account transfers to an MFDA account and there are non-exempt securities pre-existing in the client's registered plan, then a facility is required to hold these assets. The omnibus account provides this function. The relationship with the IDA member would provide the trading ability if and when the investor ever wanted to sell the non mutual fund security assets.

2. Are there other relevant business arrangements that have developed in response to these industry trends? If so, please describe.

Response: MRSI's business structure was developed in response to these industry trends and was established in compliance with requirements specified by the Ontario Securities Commission in 1999. The structure has been reviewed by the MFDA in the context of MRSI's application for membership as well as in subsequent meetings in October 2002 with Mr. Mark Gordon, Ms Karen McGuinness and others at the MFDA. MRSI's IDA member affiliate, M.R.S. Securities Services Inc. responded to the joint omnibus survey conducted by the IDA in January 2003. Senior officers of MRSI and MRSSSI were interviewed by representatives from the IDA and MFDA as part of their 2003 joint project to analyze specific business arrangements between IDA and MFDA member firms.

The following is a brief description of the equity and non-exempt fixed income trading services MRSSSI and its affiliates, M.R.S. Trust Company ("MRS trust") and M.R.S. Securities Services Inc. ("MRSSSI"), provide for registered plans.

All trades in non-exempt securities are executed in DAP/RAP accounts at MRSSSI by licensed investment representatives and are settled in MRS Trust registered plans. Clients open accounts and place orders directly with licensed investment representatives at MRSSSI. Account

supervision, including new account opening and suitability reviews are conducted in accordance with IDA requirements. Filled trades settle on a DAP/RAP basis into the MRS Trust registered plans where client positions (cash and securities) are held. Trade confirmations and statements for MRSSSI DAP/RAP accounts are issued by MRSSSI as per IDA requirements and state that MRSSSI is the dealer and representative of record. Client account statements for MRS Trust registered plans are issued by MRS Trust. MRS Trust statements include deliver and receive transactions for non-exempt securities. The Dealer and Representative of record shown on statements will be both the mutual fund dealer and MRSSSI. MRS Trust statements are issued quarterly.

The following are the roles/responsibilities of each participant in the provision of this equity trading service:

MRS Trust	trustee of registered plans
MRSI	agent of MRS Trust to administer registered plans. MRS Trust and MRSI are responsible for the books and records of all positions held in registered plans.
MRSSSI	direct trading facility for clients who wish to trade in non-exempt securities. MRSSSI executes trades on an unsolicited basis and does not make recommendations, offer advice, or discuss the merits of any trade or investment. MRSSSI is responsible for the maintenance of books and records for all MRSSSI DAP/RAP account opening and trading activity.
National Bank Correspondent Network ("NBCN")	NBCN is custodian for all non-exempt securities. MRSI, as agent of MRS Trust, has appointed MRSSSI and through it NBCN to act as custodian for non-exempt securities held in MRS Trust registered plans. All these assets are held on NBCN's books in an omnibus account. The role of NBCN is invisible to clients. All positions in the omnibus accounts are fully paid for and are segregated at NBCN.
Mutual Fund Dealers and their Sales Representatives	Provide advice and execute trades in mutual funds, GICs and exempt fixed income securities (where permitted). Dealers are able to passively refer clients with non-exempt security trading needs to MRSSSI. MRSSSI will only open accounts for clients and take orders from the client and, providing orders are suitable, will execute the trade.

Omnibus Account Arrangements

3. How are clients being properly served when only a portion of the portfolio held by the mutual fund dealer can be serviced by the mutual fund dealer?

Response: It depends on how we interpret the word "serviced". A sophisticated investor may only require a facility to execute a transaction in a non-exempt security whether it be shares acquired through a stock option plan or a desire to hold some government backed fixed income or as previously mentioned to liquidate a holding acquired through another relationship with another securities dealer. This is the same relationship an investor would have with a discount brokerage firm today. In most instances (as has been our experience) the non-mutual fund holding represents a small portion of the client's registered plan and he or she may not require advice but merely a means to execute the trade. In the IDA world we believe there are instances where a client who wants to trade in options or futures may have to do so through another advisor at the IDA firm because their advisor is not licensed. In this scenario the investor is being serviced by two separate advisors and we see no difference between the two scenarios.

4. What actions can be taken to ensure that the mutual fund dealer salesperson is acting within the terms of his/her registration regardless of client pressure?

Response: We believe that the mutual fund dealer needs to provide the investor with up front and continuous disclose. Mutual fund dealers who take part in referral arrangements should be encouraged to (a) ensure their representatives are aware of their obligation not to advise in securities where they are not licensed and (b) investors who also sign referral agreements where disclosure concerning fees are discussed should also be told that they should not be seeking nor receiving investment advice regarding non-exempt securities from their mutual fund licensed sales representatives.

In reference to the MRS business arrangement described in the response to question 2, MRSSSI explicitly communicates to mutual fund dealers and their financial advisors in the written communications it provides what they can and cannot do. MRSSSI states that -

Mutual fund dealers and their financial advisors may only refer clients to MRSSSI and must NOT discuss equities or non-exempt fixed income securities, or any trade in those securities, with clients. The referral to MRSSSI should be passive. MRSSSI will take trade instructions directly from the clients.

The account statement that the investor receives should also disclose the name of the dealer and advisor for mutual funds and, if the dealer supplies a portfolio summary including investments in non-exempt securities, the statement should also disclose the name of the investor's dealer and advisor for non mutual fund securities.

5. What actions, if any, are being taken by mutual fund dealers to ensure that clients are aware of the lack of coverage on assets held by the mutual fund dealers at investment dealers? What actions should be taken in this regard?

Response: We agree that coverage for investors' assets in the event of their dealers' insolvency is a fundamentally important issue for our industry and we believe that the OSC, the MFDA and the IDA are working towards implementing a protection fund that will benefit mutual fund investors. Upon the introduction of such a fund, we would take immediate steps to comply with any disclosure requirements, similar to those in place for CIPF member firms, to advise clients of their rights.

In specific response to this question, given that the mutual fund portion of investors' accounts do not currently benefit from coverage it is unlikely that disclosure regarding coverage is made regarding those assets held in omnibus accounts. If the OSC continues to permit omnibus account structures in future, we suggest that disclosure requirements be made mandatory. This could be similar to the requirement in MFDA Member Regulation Notice – Portfolio Summaries (MR-0024)¹ that a statement be included in client reporting explaining that the MFDA's Investor Protection Corporation does not necessarily apply to all of the positions disclosed and that the client should refer to the Member's official account statement to determine which client assets are eligible for coverage.

6. What controls or requirements could be put in place to ensure that mutual fund dealers are only trading and providing advice on mutual fund securities, while allowing clients to consolidate their holdings in one account?

Response: We suggest that mutual fund dealers who report non-exempt securities holdings on a portfolio summary or have a referral agreement with an IDA member should include, as part of their account supervision procedures, a responsibility to monitor trading to identify patterns that may indicate that a financial advisor is acting outside the scope of his or her license. For

¹ Issued February 24, 2004.

example, if a financial advisor has a number of clients with transactions in the same security, and the financial advisor is not licensed to trade in those securities, then a red flag should be raised for the compliance officer. Concentration rules could apply to mutual fund dealers with referral arrangements as well. In addition, we suggest that mutual fund dealers should review the personal account statements of their financial advisors (either in house accounts or external accounts) for activity in non-exempt securities that may also exist in the financial advisors' client accounts. Lastly, we suggest that mutual fund dealers' adopt a permitted percentage range of non mutual fund securities in a mutual fund account. If a client wishes to exceed that range or if account activity becomes inconsistent with the established range, then the mutual fund dealer could take action to arrange for the client to transfer his or her account to an investment dealer.

Joint Service Arrangements

You may know that as a large scale carrying dealer, MRSI does not maintain a sales force and therefore is not in a position to comment from experience on account supervision of salespersons in joint service arrangements. Accordingly, we have opted not to respond to questions 7 to 10 of the Issues Paper.

7. Under our current regulatory framework, what actions, if any, can be taken to address concerns regarding supervision of salespersons in joint service arrangements? How can clear lines of responsibility of each of the dealers be maintained?

Response: None

8. How can we ensure that responsibility and liability of dealers in joint service arrangements to clients is clear?

Response: None

9. What controls, if any, could be put in place to prevent client confusion?

Response: None

10. Can you suggest any alternative solutions that would address the supervisory, accountability and liability issues that arise when salespersons act on behalf of two dealers?

Response: None

11. What changes, if any, would you support so as to allow the mutual fund salesperson to service the investment dealer account?

Response: MRSI supports the concept of a restricted license financial advisor (limited to mutual funds) be permitted to be employed by an investment dealer.

Alternatives Considered

12. Referral arrangements require that clients have separate accounts at each dealer, instead of one consolidated account. The need for separate accounts may raise issues of convenience from the client's perspective; beyond this, are there any issues or consequences of referral arrangements that we should be aware of?

Response: We suggest that there are two other important considerations regarding establishing separate accounts being (a) cost of maintaining two separate registered plans and (b) foreign content management within registered plans. Please note that the MRSI business structure we

describe in question 2 permits one registered plan account to hold both mutual fund and non-exempt securities. This benefits investors since they pay only one annual trustee fee and have a structure that provides consolidated reporting and assessment of foreign content exposure.

13. If the MFDA/IDA introducer/carrier model contemplates two dealers servicing one client account, how can clear lines of responsibility (including supervision, accountability and liability) of each of the dealers be maintained? Alternatively, if this introducer/carrier model contemplates two dealers servicing two client accounts, how does this meet clients' need? Furthermore, what actions can be taken to ensure that the mutual fund dealer salesperson is acting within the terms of his/her registration?

Response: MRSI has some concerns regarding the feasibility of two dealers servicing one account since we believe that this structure would promote competition between the two financial advisors for the same assets and would obscure the ability of the dealers' operations and compliance areas from monitoring trading activity and compliance. We suggest this type of arrangement could ultimately raise more concerns than exist today.

In response to the second part of this question, the MRSI business structure described in question 2 above is, in effect, a two dealers servicing two accounts model since the mutual fund dealer continues to service his or her client's mutual fund trading needs and MRSSSI provides investors with a discount brokerage solution for their non-exempt securities. MRSI believes that this meets clients' needs since there is one registered plan account statement issued by MRS Trust, one registered plan fee and one foreign content calculation.

14. Are you aware of any arrangements that would allow a mutual fund dealer to service its clients' need for one consolidated account, yet do not raise these regulatory concerns?

Response: MRSI believes that its business arrangements described in response to question 2 above allows mutual fund dealers to service their clients' needs for one registered plan account. The structure addresses a number of the regulatory concerns identified in the Issues Paper since all trading activity in non-exempt securities takes place at MRSSSI, there is clear disclosure to investors in the registered plan statement of the two dealers of record and account supervision and monitoring is provided by the respective dealer firms, being the mutual fund introducing dealer for mutual fund assets and at MRSSSI for non-exempt securities.

15. What are alternative solutions to the issues raised by the OSC with respect to joint service and omnibus account arrangements? Do these solutions require changes to the regulatory structure or requirements?

Response: The following alternative solutions could provide solutions to the joint service and omnibus account arrangements:

- (1) Split the accounts between the mutual fund dealer and investment dealer.
- (2) Equities are traded at the investment dealer and mutual funds are traded at the mutual fund dealer.
- (3) Two separate registered accounts linked for registered plan reporting, statement issuance and foreign content reporting. In other words, two separate accounts under one trustee plan for reporting purposes.

16. Does a restricted dealer registration category continue to be appropriate in the current business environment where clients want to have one consolidated account and be serviced by one sales representative?

Response: We understand the OSC is considering eliminating the mutual fund dealer registration category. If this change were to be implemented, we assume that existing mutual fund dealers and their advisors would be required to either join the IDA and become investment dealers or get

out of the business. We have no knowledge that the mutual fund dealer category has been abused through the use of joint service and omnibus arrangements and, in the absence of information about harm to investors, we believe that this is a rather drastic and unnecessary solution to what is a solvable and controllable problem. The joint service and omnibus relationships identified in the Issues Paper were formed when mutual fund dealers and financial advisors were trying to satisfy investors' needs and we believe that mutual fund dealers and financial advisors are well aware of the fact that they cannot trade and advise in non-exempt securities and therefore looked to certain IDA members for assistance. IDA firms partnered with mutual fund dealer firms to develop a solution to these needs, presumably with the knowledge of the IDA, the OSC and now the MFDA. To now suggest that the only way to resolve this is to eliminate the restricted dealer registration is far too drastic and would quite significantly disrupt the industry, not to mention the lives of many people both investor and advisors alike. We suggest that more time needs to be spent exploring solutions that work and then informing mutual fund dealers and the investment dealers as to what is acceptable and what is not. We need to develop better reporting for monitoring and enforce strict penalties for those who are found in violation of the trading limitations that their license carries before we eliminate the restricted dealer registration category. We believe that this drastic step is not warranted given that there we are not aware that there is wide spread abuse of this category and the fact that MRSI's account base shows that the number of accounts holding non-mutual fund assets is a small percentage.

17. If mutual fund dealers and investment dealers are required to unwind the joint service and omnibus account arrangements, what will the impact be to your firm's clients, as well as to your firm, and how long do you anticipate this will take?

Response: MRS Does not take part in either type of arrangement so the impact would be nil.