

#### 13.1.4 Proposed Amendments to MFDA Rule 2.6 Borrowing for Securities Purchases

### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

#### PROPOSED AMENDMENTS TO MFDA RULE 2.6

#### (BORROWING FOR SECURITIES PURCHASES)

## I. OVERVIEW

### A. Current Rule

Rule 2.6 currently requires Members to provide each client with a risk disclosure document containing information prescribed by the MFDA upon: (i) the opening of a new account; and (ii) when an Approved Person makes a recommendation for purchasing securities by borrowing or otherwise becomes aware of a client borrowing money for the purpose of investment. The Member need not provide the risk disclosure document required in (ii) if it has already been provided to the client within the six-month period prior to the Approved Person making such a recommendation or becoming aware that the client is going to invest with borrowed funds.

Member Regulation Notice MR-0006 *Borrowing Money to Buy Securities (Leveraging)* ("MR-0006") currently sets out the information that must be included in the risk disclosure document prescribed by Rule 2.6.

### B. The Issues

Rule 2.6 is intended to ensure that clients receive balanced and timely disclosure in respect of the risks associated with leveraging. The MFDA has received comments from Members requesting that Rule 2.6 be amended to require leverage risk disclosure only when an Approved Person makes a recommendation to invest using borrowed funds or becomes aware of a client borrowing for investment. Members indicated that the requirement to provide such disclosure on account opening, irrespective of whether leverage is recommended or adopted as a strategy by a client on his/her own initiative, is unnecessary and confusing to clients.

Members have also requested an amendment to exempt Registered Retirement Savings Plan ("RRSP") loans from the disclosure requirements of Rule 2.6. It has been suggested that where clients borrow to invest in an RRSP, the risks are significantly lower and mitigated by the presence of contribution limits for such investments and the availability of a tax refund.

During the course of its regulatory activities, the MFDA has observed that clients fail to fully understand the risks of leveraging and other key considerations as a result of not having been provided with a balanced presentation of such information prior to borrowing to invest. In conjunction with the proposed amendments to MFDA Rule 2.6, MFDA staff will be revising the prescribed risk disclosure language in MR-0006 to address this situation by providing a brief explanation of key risks and relevant considerations in plain language.

### C. Objectives

The objectives of the proposed amendments are to ensure that clients receive useful and timely disclosure of the risks of leveraging by requiring such disclosure when necessary and exempting RRSPs, where the risks associated with borrowing to invest are low or mitigated.

### D. Effect of Proposed Amendments

The proposed amendments will ensure that clients receive disclosure of the key risks associated with leveraging when it is most meaningful by limiting delivery of the risk disclosure document to instances where leverage is being recommended to the client and when the Approved Person becomes aware of a client borrowing money to invest. The proposed amendments will reduce potential client confusion associated with receiving a document that may not be relevant to client circumstances on account opening.

## II. DETAILED ANALYSIS

### A. Proposed Amendments

The proposed amendments will eliminate the requirement for a risk disclosure document to be provided on the opening of a new account and continue to require that such disclosure be provided when an Approved Person makes a recommendation to invest using borrowed funds or otherwise becomes aware of a client borrowing monies to invest. A new subsection has been added to Rule 2.6, which provides that a Member need not provide a client with a risk disclosure document where an Approved Person

makes a recommendation to borrow or otherwise becomes aware of a client borrowing money to invest in an RRSP.

**B. Issues and Alternatives Considered**

No other issues or alternatives were considered.

**C. Comparison with Similar Provisions**

IIROC Rule 29.26(1)(a)(i) requires that a risk disclosure statement be provided on the opening of a new account. As noted above, the MFDA supports the proposed amendments which move away from this requirement as it is of the view that risk disclosure should only be required when an Approved Person recommends leveraging to a client or becomes aware that a client is considering investing with borrowed funds. Requiring leverage disclosure at account opening, irrespective of whether it has been recommended or is being independently considered by the client, creates unnecessary disclosures that can confuse clients.

The proposed amendments are consistent with section 5.8(1) of proposed National Instrument 31-103 *Registration Requirements* ("NI 31-103"), which does not require that a risk disclosure document be provided on account opening. Section 5.8(1) requires a registrant recommending the use of borrowed money to finance a purchase to provide a risk disclosure statement before the purchase.

IIROC Rule 29.26 and section 5.8 of proposed NI 31-103 do not provide an exception for RRSPs. The MFDA has not identified suitability concerns with respect to borrowing to invest in RRSPs and the risks associated with leveraging in these circumstances are mitigated by the presence of contribution limits for such investments and the availability of a tax refund that can be applied to loan repayments.

**D. Systems Impact of Amendments**

It is not anticipated that there will be a significant systems impact on Members as a result of the proposed amendments.

**E. Best Interests of the Capital Markets**

The Board has determined that the proposed amendments are in the best interests of the capital markets.

**F. Public Interest Objective**

The proposed amendments are in the public interest and will improve the Rule by limiting required delivery of the leverage risk disclosure document to instances where it is most relevant and meaningful to the client, thereby reducing potential client confusion.

**III. COMMENTARY**

**A. Filing in Other Jurisdictions**

The proposed amendments will be filed for approval with the Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

**B. Effectiveness**

The proposed amendments are simple and effective.

**C. Process**

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on September 24, 2008.

**D. Effective Date**

The proposed amendments will be effective on a date to be subsequently determined by the MFDA.

**IV. SOURCES**

MFDA Rule 2.6  
MFDA Member Regulation Notice MR-0006

**V. REQUIREMENT TO PUBLISH FOR COMMENT**

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

**The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments.** Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Sarah Corrigan-Brown, Senior Legal Counsel, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at: [www.mfda.ca](http://www.mfda.ca).

Questions may be referred to:

Paige Ward  
Director of Policy and Regulatory Affairs  
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THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

BORROWING FOR SECURITIES PURCHASES (Rule 2.6)

On September 24, 2008, the Board of Directors of Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 2.6:

**2.6 BORROWING FOR SECURITIES PURCHASES**

(a) Each Member shall provide to each client ~~a risk disclosure document containing the information~~ prescribed by the Corporation ~~when~~ when an Approved Person makes a recommendation for purchasing securities by borrowing, or otherwise becomes aware of a client borrowing monies to invest.

~~(a) a new account is opened for the client; and~~

~~(b) when an Approved Person makes a recommendation for purchasing securities by borrowing, or otherwise becomes aware of a client borrowing monies for the purpose of investment;~~

~~(b) provided that a~~ A Member is not required to comply with paragraph ~~(b)~~ if such a risk disclosure document has been provided to the client by the Member within the six month period prior to such recommendation or becoming so aware.

~~(c) A Member is not required to comply with paragraph (a) where an Approved Person makes a recommendation to borrow or otherwise becomes aware of the client borrowing monies to invest in a registered retirement savings plan.~~