



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

Contact: Paige Ward
Director, Policy & Regulatory Affairs
Phone: 416-943-5838
E-mail: pward@mfd.ca

BULLETIN #0484 – P
June 30, 2011

MFDA Bulletin

Policy

For Distribution to Relevant Parties within your Firm

Consultation Paper on the Use of Third Party Back-Office Service Providers

MFDA staff has been consistently asked by Members for assistance in addressing issues arising with respect to third party back-office service providers. MFDA staff is issuing a consultation paper to solicit feedback from Members, third party back-office service providers, and other industry stakeholders to identify regulatory concerns with the use of third party back-office service providers and solutions to address these concerns to improve overall compliance within the membership. The consultation paper is attached as Schedule “A” to this bulletin.

Please submit your comments to Paige Ward, Director of Policy and Regulatory Affairs (pward@mfd.ca) by **September 30, 2011**. In order to avoid unintended disclosure of proprietary or confidential information relating to back-office service providers, submissions will not be made public. The MFDA will however issue a general summary of comments received.

DM#258782



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

Schedule “A”

THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

**Consultation Paper on
Use of Third Party Back-Office Service Providers**

June 30, 2011

1. Background

MFDA staff has been consistently asked by Members for assistance in addressing issues arising with respect to third party back-office service providers. The “back-office services” referred to in this paper include software or systems used for processing trades, generating and maintaining required books and records (such as trade blotters and client account statements), and supervising compliance with regulatory requirements (for example, trade exception reports or new account approvals).

There are at least 12 third party back-office service providers currently engaged by MFDA Members. Approximately 71% of MFDA Members use five third party back-office service providers, with two of the five servicing just over 50% of active Members. There are also certain MFDA Members that have developed their own proprietary back-office systems. This paper discusses concerns that arise where Members use third party back-office service providers. Such concerns are not relevant to Members that use proprietary systems, as they are in a position to effect changes to ensure compliance with regulatory requirements.

MFDA staff is issuing this consultation paper to solicit feedback from Members, third party back-office service providers, and other industry stakeholders to identify regulatory concerns with the use of third party back-office service providers and solutions to address these concerns to improve overall compliance within the membership.

2. Regulatory Issues

2.1 System Changes

Third party back-office systems play an important role in Member compliance with regulatory requirements. Where Members have developed a proprietary system solely for their own use, they can make necessary changes using internal resources to ensure the systems achieve compliance with regulatory requirements. However, where Members use third party back-office service providers, Members have to rely on the development efforts of the third party. Where MFDA staff has identified issues with back-office systems and requested changes, Members have voiced concern about the fact that a service provider is unable to make necessary changes within a reasonable time or without incurring significant costs.

Additionally, in some instances, third party back-office service providers have not made necessary changes to their core systems to meet new regulatory requirements or, alternatively, have made system changes that have resulted in non-compliance with MFDA requirements.

2.2 Member Due Diligence

Some third party back-office service providers market their systems as “MFDA compliant” and certain Members, particularly those with limited compliance resources, may rely on these representations without performing a detailed review of the system. Further, MFDA staff may not be aware of a new back-office system until the system is already in use. Given the difficulties

in changing third party back-office service providers or making system modifications, systems must be reviewed to ensure compliance with regulatory requirements prior to implementation.

2.3 Books and Records

MFDA staff has observed that some third party back-office systems do not capture or maintain the data necessary to meet the record-keeping requirements under MFDA Rule 5.

2.4 Compliance Tools

Some third party back-office service providers have incorporated compliance tools or modules into their systems to assist Members in their supervisory activities. In some cases, the tools themselves may not result in compliance with MFDA requirements, or may not be used properly to ensure compliance with MFDA requirements.

3. Options

MFDA staff drafted a Memorandum to the MFDA Policy Advisory Committee (“PAC”) outlining the issues reviewed in this consultation paper. The following discussion details potential alternatives that have been discussed with the MFDA PAC. MFDA staff is considering these alternatives and any other recommendations that Members and stakeholders may have in an effort to address the concerns identified.

3.1 Rule Amendment

Currently, the MFDA has informal arrangements with the main third party back-office service providers, in which MFDA staff reviews the systems and discusses new regulatory requirements from time to time. MFDA Rule 1.1.3 could be amended to require Members to only use third party back-office service providers that are approved by the MFDA. MFDA staff could review and approve systems, enter into standard contractual arrangements with the service providers, and publish an “approved list” of service providers.

Most systems will already have been reviewed as part of the MFDA’s compliance examination process. Existing service providers could be given a transition period to address any identified concerns. New service providers would be required to demonstrate that their system is compliant with MFDA requirements before use by Members. Upgrades or revisions to the system that would have a material impact on the records or supervisory processes of a Member would require pre-approval by MFDA staff.

3.2 Non-Mandatory List of Reviewed and Approved Service Providers

MFDA staff could develop a list of third party back-office service providers whose systems have been reviewed and approved as compliant with MFDA requirements in the manner described above. This alternative would not contemplate a Rule amendment and, accordingly, Members would not be required to exclusively use the back-office service providers identified on the list.

3.3. Maintain Status Quo with Amendment to Policy No. 6 *Information Reporting Requirements*

Currently, where deficiencies in a system are identified, MFDA staff provides notification to the service provider and all Members using the system outlining how the system does not meet MFDA requirements. The MFDA could continue with this approach. In order to ensure that MFDA staff has an accurate and up-to-date list of third party back-office service providers used by Members, amendments could also be made to MFDA Policy No. 6 *Information Reporting Requirements* to require Members to notify the MFDA of the use of, or change in, back-office service providers.

4. Issues to Consider

PAC members identified the following issues for further consideration:

Member Business Decisions

1. Some may view the relationship between Members and their third party back-office service providers, as well as the systems they use, as individual Member business decisions that are beyond the MFDA's mandate to oversee Member compliance and regulatory matters.
2. The use of third party back-office service providers and the issues that may arise as a result of reliance on their systems may also be individual business decisions. Most systems are highly customizable on a firm-by-firm basis, and the related issues are highly dependent on the particular business model of the Member.

MFDA staff clarified at the PAC meeting that it is only considering reviewing basic back-office modules and is not concerned with customization, although, at times, it may not be easy to identify what constitutes the basic module.

Effect on Competition

3. Concerns may arise with respect to the requirement for third party back-office service providers to be approved by the MFDA, which may lead to barriers to entry for smaller service providers that may not be able to compete with larger firms. In addition, there could be a concern that smaller Members may have less choice and, possibly, higher expenses in relation to back-office systems.

At the PAC meeting, MFDA staff noted that, alternatively, the review and approval of back-office service providers by the MFDA could result in helping small service providers stay in business by preventing situations of non-compliance by Members that use their systems and resulting regulatory action. As a consequence, the initiative may result in Members having a broader choice of third party back-office service providers whose systems are cheaper to use.

MFDA Staffing and Resources

4. Concerns were expressed with respect to the staffing and resources that would be required should the MFDA develop an approved list of third party back-office service providers whose systems Members must use.

At the PAC meeting, MFDA staff noted that it already has familiarity with the existing systems and accordingly would not require new staff to review such systems. Further, MFDA staff does not anticipate proposing to conduct technical testing of back-office systems.

5. Request for Comments

In order to assist MFDA staff in considering how to address the issues outlined in this paper, comment from Members and other industry stakeholders is sought on the following questions:

1. What are your views on the options and issues discussed above?
2. Do you have any other recommendations or alternatives that may achieve the desired outcomes?
3. Are there any other regulatory issues or concerns with the use of third party back-office service providers that are not identified in this consultation paper?

In order to avoid unintended disclosure of proprietary or confidential information relating to back-office service providers, submissions will not be made public. The MFDA will, however, issue a general summary of comments received.

Please submit your comments to Paige Ward, Director of Policy and Regulatory Affairs (ward@mfd.ca) by **September 30, 2011**.