



Contact: Matthew Brady
Managing Director, Compliance
Phone: (416) 943-4621
Email: mbrady@mfda.ca

MSN-0084
February 26, 2016

MFDA STAFF NOTICE

ADVANCE INSTRUCTIONS FOR ACCOUNT REBALANCING

MFDA Staff Notices are intended to assist Members and their Approved Persons in the interpretation, application of and compliance with requirements under MFDA By-laws and Rules. Notices make reference to these requirements and set out MFDA staff's interpretation of how to comply with these requirements. Notices may also include best practices or guidance.

Introduction

There are several types of advance or automatic instructions that are common in the mutual fund industry, including pre-authorized contributions and systematic withdrawal plans. In these instances, specific client instructions are obtained regarding the mutual funds to be transacted and the timing and amount of the recurring transactions.

Some Members have expressed interest in implementing a process for clients to provide advance instructions to have their account(s) rebalanced to a set target asset allocation. Clients would document their target allocation specifying the percentage to be allocated to each of the specific mutual funds or investments in the account. The instructions would also specify the timing and frequency of the rebalancing activity (e.g. the last business day of each quarter) and the amount of the drift or variance from the target allocation that would trigger rebalancing.

When determining if this type of program can be implemented, Members must ensure they comply with the following MFDA Rules:

- **MFDA Rule 5.1(b)** which states that each Member shall maintain an adequate record of each order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted; and
- **MFDA Rule 2.3.1** which prohibits the Member or its Approved Person from engaging in any discretionary trading.

Adequate Record of Client Instructions

An adequate record of client instructions for rebalancing transactions should include:

- The account;
- The rebalancing timing and frequency;
- The target allocation specifying the allocation to each of the specific mutual funds or investments; and
- The percentage of variance or drift that would trigger rebalancing.

No Discretionary Trading

Members must be careful when implementing a rebalancing program to ensure there is no discretionary trading. Examples of activities that would not be compliant include, but are not limited to, the following:

- Obtaining client authorization for general asset allocation percentages but allowing the Member or Approved Person discretion in selecting the specific mutual funds or investments;
- Member or Approved Person discretion regarding the timing, frequency or conditions for rebalancing; and
- Changes to the target allocation including fund substitutions without adequate client authorization.

Other Considerations

When implementing a rebalancing program Members should ensure redemption fees or other charges are not incurred by the client during the rebalancing process. Such fees or charges may lead to concerns regarding the suitability or fairness of the rebalancing program. Clients should also be advised that the transactions may trigger taxable events and affect their tax situation.

In addition, standing rebalancing instructions should not continue for extended periods without client contact. Accordingly, Members should implement a policy to regularly reconfirm or update client rebalancing instructions (e.g. annually). Members should also take reasonable steps to keep the KYC information on file current.

Members should consider how they will comply with other regulatory requirements including delivery of Fund Facts documents and trade confirmations.

A rebalancing program should be subject to appropriate supervision and testing, including testing the rebalancing calculations and procedures to provide assurance that rebalancing trades are accurately calculated and processed in accordance with advance client instructions. Members should also have clear written policies and procedures and provide training to Approved Persons and supervisory staff.

DM#451574