INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

Compliance interpretation bulletin

Conformité bulletin d'interprétation

To: All Chief Financial Officers, IDA Member Firms
Panel Auditors, IDA Jurisdiction Firms

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Capital Provisions for Unresolved Mutual Fund Differences

The purpose of this interpretation bulletin is to clarify and amplify the new capital requirements for unresolved differences [as announced in IDA Bulletin #2657] arising from the reconciliation of mutual fund money balances and security positions.

1. How Do Mutual Fund Differences Arise?

The common causes of mutual fund differences include:

(i) Client position transfers between Member Firms;

(ii) Client position transfers between accounts at the same Member Firm;

(iii) Dividends or dividend reinvestments;

(iv) Redemptions;

(v) Purchases;

(vi) Switches; and

(vii) Processing of PAC/AWD entries.

2. How are Mutual Funds Reconciled?

There are two methods of reconciling mutual funds:

(i) Monthly File - an electronic file is obtained from the Fund Company detailing all mutual fund positions as recorded on the Fund Company's records. The file is compared to the Member Firm's records to generate an exception report.

(ii) Monthly Statement - a statement is sent by the Fund Company to the Member Firm. The Member Firm compares the positions on the statement to its own records and manually prepares a list of exceptions.

For reconciliation and margining purposes, each individual fund in a family of funds is considered to be a separate

security,

as payment options (i.e. front-load, back-load, etc.) and risk differ. Additionally, the determination of unresolved differences and the related margin calculations must be made at an individual client account level.

3. How are Mutual Fund Differences Determined for Margin Purposes

The following are guidelines for the reconciliation of mutual funds:

(i) Security Positions

Security positions cannot be netted:

(a) Across different Fund Companies;

(b) Across different funds within the same family of funds; or

(c) Between positions held by different clients in the same fund.

(ii) Money Balances

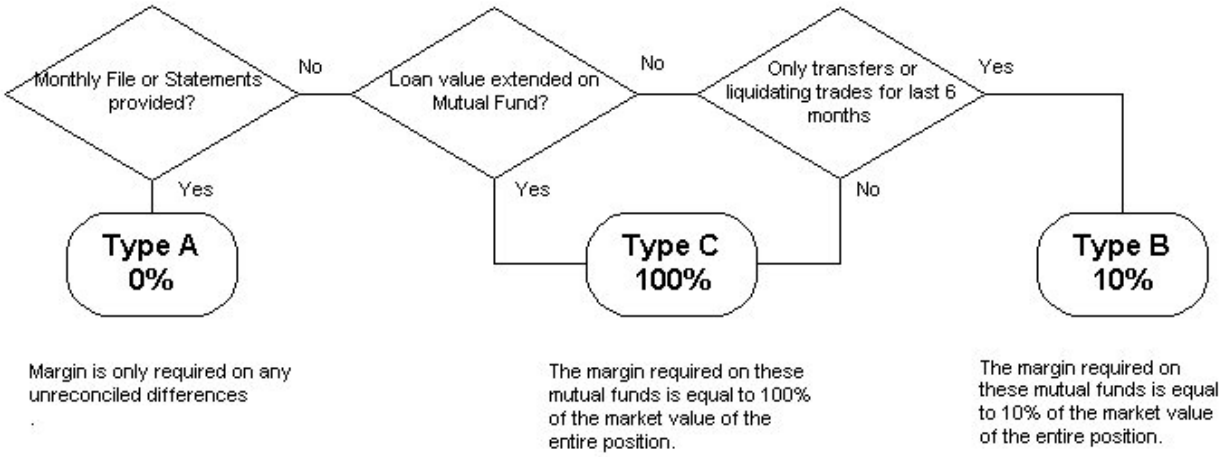
Money balances can be netted only where net money settlements are made with the Fund Company.

(iii) Mark to Market

All positions must be marked to market.

4. Margin Rates for Unresolved Mutual Fund Differences

Recent amendments to the margining rules for unresolved mutual fund differences have introduced a new margin rate for mutual funds that meet certain conditions. For margining purposes mutual funds have been classified into three types.



(i) Type A Mutual Funds

(a) Definition

Type A mutual funds are funds that provide monthly files or statements.

(b) Capital Requirement

Capital is only required on any unresolved differences.

Provision must be made, as at the reporting date of the questionnaire, for the market value and capital requirements on out of balance short securities and other adverse unresolved differences that are still unresolved as of the due date of the questionnaire.

Items are considered unresolved unless:

i. A written acknowledgment from the counterparty of a valid claim has been received; or

ii. A journal entry to resolve the difference has been processed as of the Due Date of the regulatory report.

This does not include journal entries writing off the difference to profit or loss in the period subsequent to the date of the questionnaire.

The following guidelines should be followed when calculating the capital requirement on unresolved items:

Type of Unresolved Difference	***Amount Required to Margin***
Money balance:	
(1) credit (potential gains)	None
(2) debit (potential losses)	Money balance
Unresolved Long with Money on the Member's Book	Money balance on the trade minus market value of the security[1] plus the applicable inventory margin
Unresolved Long without Money on the Member's Books	None
Unresolved Short with Money on the Member's Books	Market value of the security minus money balance on the trade[1] plus the applicable inventory margin.
Unresolved Long/Short on the Other Broker's Books	None
Short Security Break (e.g. Mutual Funds, Stock Dividends) or Unresolved Short without Money on the Member's Books	Market value of the security plus the applicable inventory margin

(ii) Type B Mutual Funds

(a) Definition

Type B mutual funds are funds that:

i. Do not provide files or statements for the month being reported on;

ii. Member Firms do not extend loan value on; and

iii. Have not had any transactions for at least six months, except for transfers or liquidating trades

(b) Capital Requirement

The margin required on these mutual funds is 10% of the market value of each individual client position, calculated as at the reporting date.

However, when known differences exist with respect to an individual client position in a Type B mutual fund, the capital which must be provided on that position is the greater of:

i. the capital that would be required if the individual client position was a Type A mutual fund (as described above); and

ii. 10% of the market value of the individual client position, as at the reporting date or the date that capital is being calculated.

The capital requirement applicable to Type B mutual funds should be applied on the date the fund is determined to be a Type B mutual fund and must be maintained as long as the fund remains a Type B mutual fund.

(iii) Type C Mutual Funds

(a) Definition

Type C mutual funds are funds that do not fall under the definition of Type A or B.

(b) Capital Requirement

The capital required on these mutual funds is 100% of the market value of the entire position, calculated as at the reporting date.

However, when known differences exist with respect to an individual client position in a Type C mutual fund, the margin which must be provided on that position is the greater of:

i. the capital that would be required if the individual client position was a Type A mutual fund (as described above); and

ii. 100% of the market value of the individual client position, as at the reporting date or the date that capital is being calculated.

The capital requirement applicable to Type C mutual funds should be applied on the date the fund is determined to be a Type C mutual fund and must be maintained as long as the fund remains a Type C mutual fund.

Examples of capital requirement calculations for a number of mutual fund transactions, which may result in mutual funds differences, are included in Appendix A, B and C.

Any questions regarding this Interpretation Bulletin should be directed to Keith Rose, Vice President, Regulatory Policy at (416) 943-6907.

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