

MSC Notice 2002-18

Request for Comments on the Regulation of Deposit Agents

Purpose of notice

The Manitoba Securities Commission (the “Commission”) is publishing for comment proposed MSC Local Rule No. 2002-__ - Regulation of Deposit Agents.

The Commission is considering regulating deposit agents. Deposit brokers, or deposit agents (hereafter “agents” is used to denote both), represents the only area of the financial services industry where third parties act as intermediaries for which there is no regulation. Indeed, there is no legislation even touching upon this area, and no way for the public to know who is a deposit agent and who is not. Nothing protects clients’ money from the moment it leaves their hands and is in transit with a deposit agent, until the money is deposited in a financial institution. Investors are entitled to this protection.

The Commission requests comment on a proposed rule as described below.

Substance and Purpose of the Proposed Instrument

Scope of rule

The proposed rule will apply to deposit agents within Manitoba, and outside Manitoba when conducting business within Manitoba, for financial institutions including all banks, trust and loan companies, credit unions, *caisses populaires*, and insurance companies. Exclusive agents of financial institutions, as defined, will be exempt from licensing or regulations. The rule will require compliance by individuals and firms, who conduct a business of deposit brokering.

Requirements

Deposit agent regulation would require that:

- agents obtain registration before operating any brokerage services, upon meeting certain criteria
- there be a *written* agency agreement between a deposit agent and a financial institution outlining the agent’s obligations and the products for which the agent is authorized to receive deposits
- specific procedures and forms be used for deposit acceptance, transmission, and final deposit
- specific procedures and forms be used by financial institutions when using the services of deposit agents and accepting deposits from such brokers
- specific business practices be prohibited
- annual reports be provided by deposit agents and financial institutions
- information be filed with the Commission under certain instances

Impact on existing deposit agents and brokers

The proposed rule would have no impact on registered dealers in acting on behalf of their clients in trading securities. Similarly, regulation would not affect licensed insurance agents in selling insurance products.

Summary and outline of proposed regulation

Application and licensing

Anyone wishing to be a deposit agent, other than an exclusive agent, will be required to obtain registration before carrying on business as a deposit agent. An exclusive agent is one who accepts deposits solely for one financial institution. The Commission proposes to allow existing deposit agents to continue to act as deposit agents, provided they apply for a license within 30 days of any rule or regulation coming into force. Further, the Commission is considering adopting a form of permanent registration where an agent would maintain a license indefinitely without requiring re-registration on an annual basis. Annual fees for registration will likely be imposed at a level to cover administrative costs.

A partnership or body corporate seeking registration as a deposit agent will have to specify the names of its partners, officers, directors and signatories, as the case may be. All agents will disclose the names of their “authorized officials”. Those persons will have to meet the requirements for registration. An authorized official will be responsible for each office of the deposit agent and only an authorized official will be permitted to accept a deposit from a depositor. A deposit agent that is a sole proprietor will be permitted to apply to have employees listed as authorized officials. For the purpose of this Notice an authorized official receiving deposits on behalf of an agent is referred to as the agent.

To be eligible to be a licensed deposit agent, a person must:

- be over the age of 18;
- be of sound mind;
- not have the status of a bankrupt;
- not have been convicted of an indictable offence, at any time, of a kind related to the qualifications, duties, or functions of a deposit agent;
- carry a surety bond;
- carry errors and omissions (professional liability) insurance; and
- be fit for registration.

The required amounts of the surety bond and insurance will be prescribed and will be in an amount necessary to cover possible losses by a depositor due to the actions of a deposit agent and any authorized officials/employees of the agent. Each of these will have to be of indefinite duration. If either of these is cancelled, the deposit agent’s registration shall be suspended and will remain suspended until the director receives evidence that the deposit agent has obtained a new bond or new insurance policy. The director may order a deposit agent to increase the amount of the bond and/or the insurance coverage where it is considered to be in the public interest.

These requirements will not impose any educational requirements on those seeking registration.

The director will maintain a register of deposit agents, and the register will be open to the public. The register will record:

- all registrations issued and renewed;
- all changes to, suspensions, revocations, and reinstatements of registration;
- the name of each deposit agent;
- the names of authorized officials of each deposit agent;
- an address for service for each deposit agent; and
- the names and addresses of each financial institution for which the agent receives deposits
- all conditions imposed on any registration.

Revocation and suspension

The director may refuse to issue registration to an applicant where the applicant does not meet the requirements of the Rule, or where the director is of the opinion that the person is not suitable to be registered.

The director may revoke or suspend registration of a deposit agent where, after an investigation and hearing, the director finds that the deposit agent:

- has been guilty of misrepresentation, fraud, deceit, or dishonesty;
- has violated any provision of The Securities Act (Act) or any rule or regulation under the Act;
- has shown incompetence or untrustworthiness in transacting the business of a deposit agent;
- has failed or refused to comply with any condition placed on the registration;
- has failed or refused to comply with any undertaking given to the director or order of the director;
- is no longer acting as a deposit agent for at least one financial institution; or
- has acted contrary to the public interest.

Where registration is revoked or suspended, the director will notify the deposit agent and any financial institutions receiving deposits from that deposit agent. The decision of the director is appealable pursuant to the applicable provisions under the Act.

The director may also investigate the activities of an authorized official, and remove the name of an authorized official from the agent's registration for the same reasons that agent's registration can be revoked or suspended. Prior to the director refusing to grant or renew registration, the director shall first give the applicant or deposit agent an opportunity to be heard.

Bonding and insurance coverage

Applicants must provide proof that they carry liability (errors and omissions) insurance. They must provide this proof when applying for registration as a deposit agent. Deposit agents must remain insured while carrying on business. Also, agents must be bonded, and provide proof of bonding when registering. Finally, deposit agents must maintain bonding while carrying on deposit brokerage business. The insurance and bonding will occur with the activities of a deposit agent and its authorized officials receiving deposits on its behalf.

Obligations of deposit agents

Service Contract

Before an agent can accept money, he will have to have a Service Contract in place between him and the investor. A Service Contract will govern the relationship between the agent and the person from whom the agent will be taking money. The details, terms, and requirements of a Service Contract will be outlined in the Rule. First, the Service Contract will require that standard forms be used in all transactions between the agent and the investor. Second, it should be noted that a separate set of standard forms would be required and used between agents and financial institutions. Third, because each deposit is a separate transaction, agents would have to enter a new Service Contract and complete the necessary forms each time a deposit is transmitted.

The standard forms, to be completed by the agent and confirmed by the investor will contain:

- the agent's name and registration number
- the investor's name
- the amount of deposit
- the name of the financial institution in which the funds will be deposited

- the date of the contract
- the date of acceptance of the funds
- a reference to a Deposit Application (see below)
- any other details pertaining to the deposit (for example, whether the funds are to be deposited in the agent's trust account)

Deposit Application

In addition to the Service Contract a separate Deposit Application form must be completed prior to or at the time of the acceptance of money. This standard form will serve as a receipt of funds received by the agent. The form will also contain an assertion that any funds received will be held in trust by the agent for the investor. It should also be noted that the Deposit Application will have to meet the deposit requirements of the financial institution. Thus, the forms would have to allow the agent to make a deposit at the financial institution on behalf of the investor. The investor and agent will both sign the forms acknowledging receipt of funds by the agent. In addition to the signatures of both parties, the forms would also require the following information to be completed:

- a reference to the Service Contract, including a reference number and date
- the name of the financial institution accepting the deposit
- the name of the financial product
- the amount to be given in exchange for the financial product
- the interest rate, term, and any special conditions of the financial product
- an acknowledgement that, where applicable, the funds are to be held in a trust account operated and maintained by the agent
- upon deposit, the agent and financial institution shall, on the form, acknowledge deposit and purchase of the financial product, including the date and confirmation number, if any, relating to the deposit

A copy of the Deposit Application must be forwarded to the investor upon the funds being deposited with the financial institution.

Receiving investor funds

If the investor's deposit is cash, the agent shall provide a receipt for the funds immediately upon receipt of the cash. If the investor makes a deposit by cheque, draft, or money order, for the purchase of a single financial product at one financial institution, he must make payment in the name of the financial institution receiving the deposit. If the investor requires the agent to split the deposit between two or more financial institutions, or between two or more financial products, or any combination thereof, then payment may be made to the deposit agent in trust. If this is the case, then the investor *must* provide detailed written instructions on the Deposit Application outlining at which financial institution the funds are to be deposited, the product they are to be used for, and the amount of funds to be used.

Where the deposit is cash or funds payable to an agent, the agent will have to:

- keep the funds separate and apart from other money belonging to the deposit agent;
- deposit the funds in a trust account;
- deposit the funds with the financial institution according to the investor's instructions no later than the next banking day;
- forward the funds to the financial institution in full with no amount being deducted for commissions, fees, or other consideration; and
- provide a receipt to the investor for funds received, immediately upon receipt.

In limited circumstances, as set out below, a deposit agent may sign a Deposit Application for an investor:

- when funds of a maturing deposit are being reinvested; and

- the investor gives oral or written instructions to the deposit agent stating:
 - the source of the funds;
 - the terms on which the funds are to be reinvested;
 - where interest and maturity cheques are to be sent;
 - where the confirmation notice from the financial institution is to be sent; and
- the deposit agent sends, within 24 hours of completion, a copy of the Deposit Application to the investor's current address or such other address as the investor specifies.

Authorized Officials

To increase business efficiency and customer service, deposit agents will likely employ authorized officials (subagents). Simply put, authorized officials are employees authorized by the agent to receive deposit funds from investors. Authorized officials will only be able to act for one deposit agent, and a deposit agent must file a report with the respective financial institutions which sets out the names of their authorized officials. Authorized officials shall not operate trust accounts and will deposit cash or funds payable to the agent only into the agent's trust account. Authorized officials will not have to register separately but will be included under the agent's registration.

Trust accounts

Each deposit agent will be required to maintain and operate a trust account. This will allow the agent to hold funds in trust for investors, before depositing the funds in a financial institution. Except in cases where the deposit is in a form made payable to the financial institution, all funds are to be deposited into the agent's trust account until the final deposit is made. Funds deposited into a trust account operated and maintained by the agent may only be remitted to the financial institution.

Upon opening an account for the purpose of holding funds in trust, the agent must gain assurance from the financial institution where the trust account is located, that:

- the account is opened for the purpose of holding funds in trust
- the account is labeled "trust account"
- no person other than the agent shall have access to the account
- the cash in the trust account will not be used to cover shortfalls in any other accounts of the agent
- any charges against the trust account are not paid or reimbursed out of the trust account

Annual reporting

Deposit agents would be required to file an annual return with the Commission. This will include information such as the volume of deposits received and the financial institutions the deposit agent deals with. Deposit agents will also be required to retain records regarding surety bond and professional liability insurance, their agency requirements with financial institutions, and records of deposits handled. These records will be retained for eight years and will be open to examination by the Commission.

Obligations of financial institutions

Written agency agreement

Before taking deposits for a financial institution, a deposit agent will be required to have a written agency agreement with the financial institution. The proposed Rule will impose minimum conditions on agency agreements. The Commission does not expect this to be an onerous requirement, will reflect standard business practices, and will remain consistent with the common law rules of contract law. For example, the agency agreement will contain an express offer and acceptance that the deposit agent will accept funds from an investor on behalf of the financial institution, and that funds will be remitted to the financial

institution. This agreement will reflect the deposit agent's obligations to investors and the financial institution.

No financial institution shall be permitted to accept deposits from deposit agents without an agency agreement. Further, no financial institution shall be permitted to accept deposits directly from authorized officials.

Confirmation notice

The financial institution will send a written notice to the investor, confirming that the funds were deposited with the financial institution. The confirmation notice, as it is called, will also indicate the amount of funds deposited, the interest rate on the funds deposited, and investment term and maturity dates, and any other provisions of the investment or GIC. The financial institution will send this notice to the investor within two weeks of receiving the investor's funds.

In some cases, an investment certificate may replace a confirmation notice, though the certificate would still have to be sent to the investor within two weeks.

Financial institution obligations

Financial institutions using deposit agents will be required to report to the Commission certain information, including the following:

- the names and addresses of deposit agents with whom they deal;
- dismissal/termination of agents;
- refusal to accept deposits from agents;
- reporting any known breaches of the Rule;
- the name and address of a contact person for the financial institution;
- and other information pertaining to the agent and principal (to be determined).

Where Rule will not apply

The Rule will not apply to agents acting exclusively for, or branch employees of, financial institutions and securities affiliates thereof. Financial institutions include federally chartered banks, trust companies, credit unions, and caisses populaire.

Where an agent or employee is not exempted because of the above criteria, the agent may still apply for an exemption from registration under the Rule, on the basis that they are acting exclusively for a firm engaging in the financial services industry. Each application for exemption, to be made to the Commission, will be considered independently.

Further, the Rule will not apply to dealers participating in the CIPF and persons recognized by law as fiduciaries (such as executors of estates, and lawyers acting in a solicitor-client relationship where no commission is received for being a fiduciary). Additionally, the Rule will not apply to income or annuity contract, insurance contract, and variable contract sales.

Specific requests for comment

The Commission requests comments on all aspects of this discussion paper, the results of which may be used in any forthcoming Rule on this matter.

Jurisdiction

Paragraph 149.1(1) of *The Securities Act* authorizes The Manitoba Securities Commission to make rules, among other things, prescribing the conditions of registration of other requirements for registrants or any category or sub-category of registrants, including standards of practice and business conduct of registrants in dealing with their customers and clients and prospective customers and clients. This also includes governing the administration and disposition of money received pursuant to an undertaking or agreement.

Anticipated Costs and Benefits

The initial out-of-pocket costs for developing the Rule are being borne by the Commission.

The ongoing administration of the Rule is designed to be low cost. Individuals and firms wishing to register as deposit agents will be required to complete a simple form once, and file the form with the Commission.

Based on the Saskatchewan experience in regulating deposit agents, the Commission does not expect to require additional staff. Filing fees have not been determined. In Saskatchewan, the fees have not been significant and they are anticipated to be set at a level simply to cover administrative costs. The Commission proposes to adopt filing fees via an amendment to the fee schedule.

Comments

The Commission's Legal and Enforcement Division will evaluate all comments. Interested parties are invited to make written submissions with respect to the proposed Rule by June 30, 2002. A diskette containing the submission (preferably in Word or WordPerfect format) should also be submitted. Alternatively, comments may be sent via e-mail to the following e-mail addresses. Comments will be publicly available and not subject to confidentiality.

Submissions should be sent to the Commission at any of the following addresses and/or e-mail addresses:

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