

Notice of Application by the Mutual Fund Dealers Association of Canada for Recognition as a Self-Regulatory Organization

Introduction

In October 1997, the Ontario Securities Commission (the Ontario Commission) published for comment proposed Rule 31-506*(1) SRO Membership — Mutual Fund Dealers. This version of the proposed Rule would have had the effect of requiring all mutual fund dealers to become members of a recognized self-regulatory organization (SRO) by a date which was then to be determined.

Also in 1997, the Ontario Commission, with the support of the other members of the Canadian Securities Administrators (the CSA), worked with the Investment Dealers Association of Canada (the IDA) and The Investment Funds Institute of Canada (IFIC) to establish an organization that could become a SRO for mutual fund dealers in all provinces and territories of Canada. The Mutual Fund Dealers Association of Canada (the MFDA) was established in June 1998 through the joint sponsorship of the IDA and IFIC, with objectives of becoming that SRO for mutual fund dealers in all the jurisdictions of Canada, other than Quebec.

Recognition Process

On December 22, 1999, the MFDA applied to the Ontario Commission, the British Columbia Securities Commission and the Alberta Securities Commission for recognition as a SRO for mutual fund dealers. In Ontario, the MFDA applied to the Ontario Commission for recognition as a SRO for mutual fund dealers pursuant to section 21.1 of the *Securities Act* (Ontario).

Ultimately, the MFDA proposes to be the SRO for mutual fund dealers in all provinces and territories of Canada, other than Quebec. However in December 1999, the MFDA applied for recognition in the three provinces where it proposes to have Regional Offices. The Ontario Commission, the British Columbia Securities Commission and the Alberta Securities Commission will be referred to in this Notice as the “Recognizing Jurisdictions”.

In addition to releasing this Notice, the Ontario Commission is releasing a third version of proposed Rule 31-506 for a 30-day comment period on the proposed changes to the Rule. See the Notice of Proposed Changes to Proposed Rule 31-506 SRO Membership — Mutual Fund Dealers dated June 16, 2000. Proposed Rule 31-506 will require all mutual fund dealers to become members of the MFDA, in effect, within thirteen months of the date the Ontario Commission recognizes the MFDA as a SRO for mutual fund dealers. The Ontario Commission anticipates finalizing proposed Rule 31-506 so that it comes into force on the same date that it recognizes the MFDA as a SRO. Those dates are anticipated to be January 1, 2001.

As part of the MFDA's application for recognition as a SRO for as a mutual fund dealer, the MFDA delivered to staff of the Ontario Commission an application document (the Recognition Application) containing a description of the MFDA, including information on its name, its form of organization as a non-profit corporation, jurisdiction, a list of all committees and their functions,

detailed information concerning officers, directors and the chairperson of each committee, together with copies of its proposed by-law, rules, policies and forms (the draft By-law and Rules). As noted below, the Ontario Commission is publishing the Recognition Application for comment.

The Ontario Commission will publish for comment any additional materials necessary to permit informed comment. The application process may require more than one comment period.

Based on their review of the MFDA's Recognition Application and any public comments received, staff of the Ontario Commission will make recommendations to the Ontario Commission. These recommendations will likely suggest terms and conditions that staff believe should as a general matter be required for recognition of a SRO for mutual fund dealers, and may contain additional terms and conditions that respond to specific issues arising during their review. If staff identify by-law or rule changes or other issues that they believe are important, they may recommend that the Ontario Commission impose their future implementation as a condition of recognition, rather than delay recognition until the issues are resolved.

After considering the recommendations of staff and submissions of interested parties the Ontario Commission will consider the formal recognition of the MFDA as a SRO for mutual fund dealers and any terms and conditions thereof that it considers appropriate. It is expected that uniform recognition criteria will be adopted by the Recognizing Jurisdictions.

The MFDA has requested that its recognition as a SRO for mutual fund dealers occur on or before January 1, 2001. If the Ontario Commission so recognizes the MFDA effective that date, proposed Rule 31-506 will come into force also on that date.

Staff Review of MFDA Recognition Application

Since December 1999 when the MFDA submitted its Recognition Application with the Recognizing Jurisdictions, staff of the Recognizing Jurisdictions have been reviewing the Recognition Application and the draft By-law and Rules to ensure that they meet the expectations of the Recognizing Jurisdictions in supporting the establishment of the MFDA. Although staff of the Recognizing Jurisdictions will be making their final determination on the acceptability of the Recognition Application and the draft By-law and Rules once all comments thereon have been reviewed and responded to, staff note that the draft By-law and Rules published with the MFDA Recognition Application, with three notable exceptions noted below, largely meet staff's expectations.

Staff have asked the MFDA to make three substantive changes to the draft By-law and Rules and do not agree with the MFDA's proposed transition periods in respect of the impact of the capital Rules for the various categories of members. The position of the Staff of the Recognizing Jurisdictions on the three substantive areas are set out below, along with their position on the proposed transition periods. Commentators should review the Staff position when providing comments on the applicable Rules.

Financial Planning

The draft Rules of the MFDA operate such that the financial planning business of an Approved Person (a registered salesperson) does not have to be supervised by a Member (the dealer) if that business is run through an insurance brokerage (that is, “a person which is regulated by any governmental authority or statutory agency other than a securities commission”). Staff of the Recognizing Jurisdictions do not agree with this position. The MFDA's draft Rules contradict the stated position of the Canadian Securities Administrators in the CSA Distribution Structures Paper*(2) that salespersons who provide financial planning services must provide these services as employees or agents of the dealer which sponsors their registered securities activities.

The Notice of the Canadian Securities Administrators accompanying proposed Multilateral Instrument 33-107 Proficiency Requirements for Registrants Holding Themselves Out as Providing Financial Planning Advice*(3) describes the CSA's legal analysis regarding financial planning. The CSA are of the view that where an individual registered to sell one or more products also offers clients comprehensive, integrated, objective, financial advice that purports to be tailored to a client's particular circumstances, whether that advice is designated as financial planning or otherwise, that advice is part of the whole spectrum of the registrant's regulated sales and advisory activities. As such, Staff of the Recognizing Jurisdictions are of the view that the activity of “financial planning” cannot be separated from, and treated externally to, the securities regulatory regime or to the sales and advisory activities to which mutual fund dealers and their salespersons are responsible.

In supporting and encouraging the establishment of a SRO for mutual fund dealers, the CSA anticipated that this body would take responsibility for all the currently regulated activities of registrants under the “mutual fund dealer” and “mutual fund salesperson” categories of registration. The draft Rules of the MFDA operate to split the regulation of MFDA member salespersons between the MFDA and the CSA, such that so-called “financial planning” activities would remain subject to direct CSA regulation. Staff of the Recognizing Jurisdictions are not satisfied with this result. Furthermore, the CSA expects that the IDA will adopt the above noted CSA favoured approach to the financial planning activities of its salespersons. The CSA has made it clear to the MFDA that the standards for its members must meet those of the IDA.

Staff of the Recognizing Jurisdictions will continue to raise their issues with the MFDA during the comment period. The CSA Distribution Structures Paper and the CSA financial planning initiative have been aimed at addressing very serious investor protection issues raised by the public and the industry and in Staff's view, a SRO for mutual fund dealers cannot fulfil its mandate without adherence to the positions taken in these two initiatives.

Client Account Statements

The draft Rules provide for a distinction between Member's client accounts that are held in “nominee” name (that is, in the name of dealer) with fund companies and those that are held in “client” name with fund companies. With respect to client name accounts, the draft Rules require that client account statements only need be sent to clients once every twelve months. For nominee name client accounts, the draft Rules require statements to be sent either monthly or quarterly

(depending on the level of activity in that client's account with the Member). Staff of the Recognizing Jurisdictions are of the view that client account statements, that contain the information set out in the draft Rules, must be sent by dealers to clients on a monthly or quarterly basis (depending on the level of activity) regardless of how those clients' accounts are registered with the fund companies.

Staff of the Recognizing Jurisdictions will continue their discussions with the MFDA on this important investor protection matter. Regular client statements are necessary to ensure that an investor receives information on the status of his or her activities with the dealer and as a form of control mechanism for both the client and the dealer. Staff of the Recognizing Jurisdictions are of the view that their position with the MFDA Rules is consistent with current securities law requirements and the rules of the IDA.

Performance Data For Individual Accounts

Staff of the Recognizing Jurisdictions have indicated to the MFDA that the Rules should either mandate a specified format for Members to use when purporting to provide clients with individualized performance data or prohibit the provision of this performance data until such time as that guidance can be given. The MFDA have not so provided in the draft Rules. Staff of the Recognizing Jurisdictions expect to continue to discuss this issue with the MFDA and will make a final determination once all comments have been reviewed.

Transition Periods for Capital

The MFDA describes in its application how it proposes to phase in the increased capital requirements for Members — essentially over a three year period so that all Members must meet the relevant capital requirements set out in the draft Rules by the end of the third year after recognition of the MFDA as a SRO. Staff of the Recognizing Jurisdictions are of the view that the proposed transition period is too long having regard to the widely held concerns amongst the industry and the regulators that current capital levels for mutual fund dealers are too low and must be increased in order to achieve increased levels of investor protection. Staff point out that the minimum capital requirements for mutual fund dealers under securities legislation is \$25,000. Notwithstanding the fact that the MFDA may provide a transition period for the capital required of Level 1 dealers, unless an exemption is sought and obtained, securities legislation will continue to apply. Potential Level 1 Members located in Ontario who require time to achieve the full capital requirements of securities legislation should contact staff of Ontario Commission for guidance on whether an exemption would be available.

Staff will continue to discuss their concerns about the transition periods with the MFDA during the comment period and encourage submissions from commentators as to the practical need for the transition proposed by the MFDA. Staff would prefer that Members of the MFDA meet the capital requirements from the date of their Membership — however, the MFDA would have the authority to grant exemptions for special cases, on the basis now proposed (that is, a phased in capital increase over three years).

Dual Licensees

The draft Rules do not provide for any particular treatment for salespersons who are registered with the Ontario Commission (or the other Recognizing Jurisdictions, as applicable) and who are also licenced to sell insurance products. The Ontario Commission acknowledges that MFDA membership may impact on dually licensed salespersons in a unique way and has committed to work with the Canadian insurance regulators to achieve a mutual understanding and resolution to the issues.

Continued Applicability of Securities Legislation

Mutual fund dealers and their salespersons should note that through proposed Rule 31-506, mutual fund dealers will be required to become members of the MFDA within the time periods set by that Rule. Dealers and their salespersons will also be required to continue their registration with, and comply with all applicable laws and requirements of, the Ontario Commission and the other Recognizing Jurisdictions, as applicable, including the capital and notification requirements of securities legislation.

Public Comments Requested

The purpose of this Notice is to seek public comment on the criteria (the Criteria) the Ontario Commission, together with the other Recognizing Jurisdictions, proposes to use to assess the Recognition Application in determining whether or not to recognize the MFDA as a SRO for mutual fund dealers.

Staff of the Ontario Commission and the other Recognizing Jurisdictions requested that the MFDA address the Criteria in submitting its Recognition Application. The MFDA included its response to the Criteria (the MFDA Response) in its Recognition Application.

Through this Notice, the Ontario Commission also seeks public comment on the Recognition Application, including the MFDA Response and the draft By-law and Rules of the MFDA.

The proposed Criteria, the Recognition Application, including the MFDA Response and the draft By-law and Rules of the MFDA are attached to this Notice. The Recognition Application, including the MFDA Response and the draft By-Law and Rules and proposed Policies and Forms of the MFDA are also included on the web-site of the MFDA at www.mfda.ca.

Interested parties are invited to make written submissions with respect to the proposed Criteria, the Recognition Application, including the MFDA Response and the draft By-law and Rules. *All such comments will be considered, if received before September 14, 2000.*

Interested parties are also urged to review the Notice of Proposed Changes to Proposed Rule 31-506 and provide comments within the deadline noted in that Notice (being July 17, 2000)

Submissions should be sent to the Ontario Commission, in duplicate, as indicated below:

John Stevenson, Secretary

Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario
M5H 3S8
jstevenson@osc.gov.on.ca

Comments on the Recognition Application, including the MFDA Response and the draft By-law and Rules of the MFDA will be passed on to the MFDA by the Ontario Commission for response by the MFDA.

A diskette containing the submissions (in DOS or Windows format, preferably WordPerfect) should also be submitted. As securities legislation in Ontario requires that a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

Comments may also be sent via e-mail to the above-noted e-mail address of the Secretary of the Ontario Commission and also to any of the individuals noted below at their respective e-mail addresses.

Questions on the proposed Criteria and the process being followed by the Ontario Commission in considering the MFDA's application for recognition may be referred to any of:

William R. Gazzard
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Questions on the Recognition Application, including the MFDA Response and the draft By-law and Rules of the MFDA may be referred to:

Laurie Gillett
Manager of Membership Services and Corporate Secretary
Mutual Fund Dealers Association of Canada
(416) 943-5827
lgillett@mfda.ca

Proposed Criteria and Recognition Application

The text of the proposed Criteria and the Recognition Application, including the MFDA Response and the draft By-Law and Rules follow.

Dated: June 16, 2000

Endnotes

1

At (1997) 20 OSCB 5051. No comments were received on the first publication of proposed Rule 31-506. Proposed Rule 31-506 was published for a second comment period in June 1998 at (1998) 21 OSCB 3875. Five comment letters were received.

2

(1999) 22 OSCB 5258.

3

(1999) 22 OSCB 7669.