Mutual Fund Dealers Association of Canada
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April 30, 2004

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8

Dear Mr. Stevenson:

Re: Fair Dealing Model Concept Paper – Comment Letter

The Mutual Fund Dealers Association of Canada ("MFDA") is the national self-regulatory organization ("SRO") for the distribution side of the mutual fund industry. We are writing in response to your invitation to provide comments on the Fair Dealing Model ("FDM") Concept Paper.

As a national SRO, the MFDA fully supports the principles set out in the FDM Concept Paper, and the efforts the Ontario Securities Commission ("OSC") has made to ensure that clients are dealt with fairly by the investment industry. We are pleased that the paper acknowledges and endorses the continuing important role that the SROs will play in implementing the concepts envisioned by the FDM.

For the purpose this letter, we have limited our comments regarding the practical application of the Fair Dealing Model to higher level issues. Generally, most rules that are released for comment by the OSC and other provincial regulators are focused on specific points of regulation, typically with limited scope. The issues addressed in the FDM Concept Paper are extremely broad, and the process of providing commentary is very different from the traditional exercise. As well, many of these issues are currently being examined in greater detail by industry working groups established by the OSC. We would encourage the OSC to consider publishing the suggestions that come out of these groups so that a wider cross section of industry commentators will have a chance to reflect on some of the ideas and issues that are discussed. In any case, because the proposed changes are so important to the investment industry and many issues regarding implementation remain undecided, we believe that an opportunity to comment on further development of the FDM would be warranted at the appropriate time.

Harmonization

The OSC has stated its position that the Fair Dealing Model will not be implemented without the participation of other regulators. The importance of harmonization is recognized in the Concept Paper itself, which notes that the ultimate goal for the FDM is to see it adopted nationally. Having said that, the Concept Paper does lay the foundation for patchwork implementation of the model, leaving open the possibility that it could be imposed in some jurisdictions without national acceptance. There are, of course, ways to achieve workable solutions to problems that can arise when different regulators hold divergent points of view on an issue. The Concept Paper points out that jurisdictions that elect not to implement the FDM could grant exemptions to Ontario based firms on the basis that they are adequately regulated to satisfy local requirements. However, because the FDM is very different from existing regulatory regimes, there is a real concern that some of the provincial authorities might deny such exemptions, creating multiple levels of regulation for national firms. Even where exemptions are given, there may be pressure for the OSC to grant reciprocal relief to firms that are based in these other provinces. The creation of a regulatory landscape of FDM provinces and FDM exempt provinces could seriously undercut the effectiveness of implementing the model, resulting in a situation where firms simply opt for another jurisdiction to headquarter their operations. In some cases, it may be less costly to relocate the head office, than to make extensive changes to existing systems and processes.

We take comfort in the fact that the OSC continues to work with the other members of the Canadian Securities Administrators in the creation of the final model. Obviously, there is a great deal of attention presently focused on a number of important harmonization initiatives, such as the Uniform Securities Legislation project, Passport Registration, and the creation of a national securities regulator. The OSC has been a vocal advocate in favour of the move toward harmonization. A very broad base of support should be built before proceeding with the implementation of the FDM to ensure that these efforts are not undermined.

Costs

As noted above, from the perspective of our Member firms, the cost of complying with the proposed requirements will be a major factor. To be cost effective, the FDM must be designed to be relatively compatible with supervisory systems that are presently used in the industry. Ensuring that clients receive more comprehensive disclosure and better service levels is clearly a worthwhile objective, but in completing the cost/benefit analysis it must be kept in mind that these same clients may ultimately bear the costs that firms incur to meet these expectations.

One of the goals of the FDM is to give clients more of a voice in defining the service levels they can expect and the fees they will be charged under the financial service provider agreement. The model does give advantages to clients that hold significant bargaining power in the relationship. However, the costs associated with providing the prescribed service levels under an advisory relationship may cause this type of service to be priced too high for clients not classified as ‘high net worth’ by dealers. The practical aspects of implementing the model should be very carefully considered to ensure that the choice of service levels available to the average investor does not become limited to self-managed relationships. As with any regulatory model, a balance must be struck between the level of protection for the investor and the cost of implementation. Otherwise, issues relating to lack of access to services may be inadvertently created.

Registration Issues

As a general observation, the move from product based to relationship based regulation involves fundamental changes to the structure of the registration system, which could conceivably result in the elimination of the mutual fund dealer registration category. We believe that mutual fund dealers must continue to be recognized as a unique business form within the investment industry that provides valuable services to an extremely broad range of investors. The separate registration category allows regulators to maintain a balance between continuing and enhanced protection for investors with the reality that the restricted nature of these businesses warrants distinct consideration from a regulatory perspective.

It is our understanding that the intended changes would not dispense with the mutual fund dealer business model, rather that the FDM could potentially work to allow for mutual fund dealers to expand the range of services from those presently offered. The OSC has advised that registration issues will be dealt with in more detail in a second FDM concept paper. We anticipate that all of these issues will be carefully considered.

MFDA Rules and the Fair Dealing Model

The primary objective of the MFDA is to provide protection for mutual fund investors through the regulation of our Member firms. This is achieved by mandating minimum standards of conduct for Members and their Approved Persons and monitoring compliance through on-site examinations. Where it becomes apparent through compliance reviews or investor complaints that our standards have not been met, the Member and Approved Person may be subject to discipline through enforcement proceedings. Our intent is to create a regulatory environment that operates in a fair, efficient and transparent manner and we expect our Members to treat their customers with a similar level of respect. The MFDA Rules have been in force since 2001, and have proven to strike a good balance between ensuring that appropriate safeguards for investors are in place, while acknowledging the legitimate business concerns of our Members.

The core principles expressed in the Fair Dealing Model embody many of the primary elements of securities regulation. The principles can be summarized as follows:

- recognizing the different forms of relationships that clients want with their firms;
- requiring clear documentation of the relationship;
- requiring clear disclosure of the fees and risks involved with investing; and
- requiring policies and procedures to be created to manage conflicts of interest.

We would encourage commission staff to look at the complaints experience of the securities commissions and the SROs and use a risk-based approach in prioritizing the concerns that the model seeks to address. From the perspective of potential client harm, the most serious issues that we have noted in reviews and complaints revolve around questions of investment suitability combined with a lack of client understanding as to the risks of investing. If the FDM is to provide part of the solution to these issues, the first priority should be the objective of enhancing investor awareness. However, we recognize that enhancing investor awareness should not be the

sole responsibility of the dealer and that the issuer, regulators, industry associations and the investor also have roles to play. The challenge will be to strike the appropriate balance among them.

Many of the core principles of the FDM are already incorporated into the MFDA's existing Rules. Where principles may be addressed more fully, we will consider making appropriate changes. Under MFDA Rule 2.1, all Members and their Approved Persons have a responsibility to deal fairly, honestly and in good faith with their clients. Any conflict of interest that arises or can reasonably be expected to arise must be disclosed to the client and resolved in light of the best interests of the client. Other general requirements for opening and operating a client account are dealt with in other sections. Clearly, though, some aspects of the FDM are not fully expressed in our current Rules. For example, the extent of information that is exchanged between the advisor and the client in the account opening process is very comprehensive under the FDM as compared to our existing minimum requirements. The FDM provides that financial service providers must have a complete understanding of their client's circumstance to properly execute their duties in an advisory relationship. Clients must also be provided with complete, relevant and meaningful information about the nature and limitations of the services that they can expect to receive from their financial service provider, as well as the risks and costs that are associated with investing. We agree that these are important issues to be addressed and, accordingly, will consider expanding the minimum "know your client" client information prescribed under MFDA Policy 2. We may also examine implementing other possible policy changes, such as mandatory disclosure about investment basics and risk to clients on account opening.

The Fair Dealing Document

The FDM envisions three types of relationships and certain minimum levels of responsibility that must be met in each case by the dealer and the representative. In all three, the minimum standards of conduct would be similar to those that already apply, but the parties would be free to negotiate additional provisions. As the Concept Paper suggests, by clearly spelling out the expectations of both the firm and client, a sense of accountability can be reinforced. However, there is a potential that some firms might attempt to contract out of some core responsibilities by burying a disclaimer within a complex document. It has to be made clear to registrants that the fair dealing document cannot be used as a tool to escape responsibility for certain fundamental duties.

One of the purposes of the FDM is to make sure clients understand what they are buying when they sign up with a financial service provider. However, we have some concerns that using checklists for "Services Provided" like that contained in the sample fair dealing document may be a source of some confusion for clients. Consistent with current requirements where clients are directed to outside service providers by way of referral arrangements or where services are provided through representatives in a principal/agent relationship with their firm, clients must be made aware of certain details of these arrangements. The fair dealing document should be clear as to who is actually providing these additional services and the role of the financial service providers. In addition, the regulatory expectations that will apply with respect to these services should be properly defined so that these responsibilities are fully understood by clients, firms and regulators.

In summary, we would like to once again express our support for the work of the OSC in raising awareness and highlighting the principles outlined in the Fair Dealing Model. We look forward to the second concept paper and the opportunity for all industry participants to further dialogue on the continued development of this important initiative.

We would be pleased to discuss our comments further with you and provide such further particulars as might be helpful to this consultative process.

Thank you for considering our remarks.

Yours truly,

Mutual Fund Dealers Association of Canada

Mark T. Gordon
Executive Vice-President

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