Federation of
Mutual Fund Dealers

February 29th 2012

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité de marches financières
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Gordon Smith
British Columbia Securities Commission
gsmith@bcsc.bc.ca

Anne-Marie Beaudoin
Corporate Secretary
Autorité de marches financières
Consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Staff Consultation Note 45-401
Review of Minimum Amount and Accredited Investor Exemptions
Public Consultation

The Federation of Mutual Fund Dealers (the "Federation") is an association of Canadian mutual fund dealers and affiliates whose members, since 1996, have been working to be the voice of independent mutual fund dealers. We currently represent 30 dealer firms with over $114 billion of assets under administration and 17 thousand licensed advisors that provide financial services to over 3.5 million Canadians and their families.

The Federation is writing to provide comments with respect to the above captioned Consultation Note (the "Note").*

At the outset we would like to say that the members of our Board and our membership generally have consulted widely on this subject. What surfaced as a consistent theme is that in bringing the potential for changing these two exemptions to the fore, a myriad of questions regarding all available exemptions, the exempt market, capital raising and regulatory arbitrage and that much more research is warranted prior to any amendments being made to the existing policy. As well we should state that this letter represents a

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consensus of opinion of Federation Members. Should any individual Member have a stronger opinion with respect to any question posed in the Note, they may submit their own comment letter independent of the Federation. With that said, our comments follow.

While international developments may be of interest, it is unclear how these events are so directly relevant to Canadian Capital Markets as to require a review of the minimum amount exemption and the accredited investor exemption at this time. National Instrument 45-106 has been in force for just over two years, and in our view it may be premature for the CSA to turn its attention and resources at this time to two prospectus exemptions which are heavily relied upon by issuers and distributors. Given the unavailability of domestic empirical data to help assist with these deliberations we would be concerned about the additional impact of changes to the AI exemptions within the mutual fund channel as a whole.

While Appendix A to the Note provides background information with regard to a very limited selection of foreign jurisdictions, its usefulness in responding to the questions raise by CSA Staff is limited, as there is no discussion or description of any initial or on-going registration requirements and other investor protection provisions applicable to the distribution channels in these jurisdictions. A review of the impact of differing inter-provincial requirements for exempt products within Canadian jurisdictions may be quite helpful in this process. Additionally, we would urge the CSA to consider the impact of changes to the various channels of delivery for advice, which depending upon the outcome of the decision, may aggravate issues of regulatory arbitrage between channels. Mutual fund dealers are subject to robust SRO guidelines and the advisor channel naturally competes with both the IIROC and EMD channels for client funding and product distribution.

We regard the determination of the appropriate framework for prospectus exempt offerings as a matter of broad public policy and it is of importance to the economy as a whole. It is the role of government to develop and maintain a framework that ensures that investors have fair and reasonable access to investment opportunities of a type that are suitable for their objectives and needs. Moreover, there is an obligation to ensure that one capital market segment or advisory channel is not disadvantaged over another. It is critical to the functioning of these markets, that access to funding should be available at a reasonable cost to small and medium enterprises which cannot afford to offer securities by way of a prospectus offering. These offerings should be subject to a robust disclosure and suitability process regardless of the delivery channel.

Any steps that would limit the number of potential investors or increase the costs of raising capital in the prospectus exempt market would undoubtedly do considerable harm to these enterprises which are often seen as key drivers of growth and prosperity; however, these markets should be subject to the same level of client disclosure and oversight as required by other advisory channels. We would not want to limit the long term ability of such enterprises to tap into the prospectus qualified markets, as the absence of available funding would limit growth, development and innovation, all of which are needed to some extent to “go public”.

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In our view, the arbitrary determinant of a minimum investor amount is not in and of itself indicative of suitability of an investor to participate in an exempt market product offering. All investors wealthy or not have the right to access the type of investment that may be offered under an exempt offering. Arbitrarily changing the minimum limit may disadvantage otherwise qualified investors thereby abridging the very fundamental rights of an individual to have equal access to investment alternatives. We are of the view that the adoption of National Instrument ("NI") 31-103 provides an opportunity for CSA Staff to determine whether any concerns raised regarding the accredited investor and minimum purchase amount exemptions can be or already are adequately addressed by regulating all the distribution channels in a satisfactory and effective manner as a opposed to modifying or limiting these exemptions. More data is required before taking any considered steps regarding the change of minimum limits.

While we appreciate the need to establish "reasonable" minimum criteria for investors who wish to acquire prospectus exempt securities, it is important to accept the proposition that adults as potential investors ultimately should be responsible for their decisions, absent their reliance on a third party that has a statutory or common law duty of care to provide appropriate advice. With the adoption of NI 31-103, all registered dealers and their representatives have a statutory "suitability" obligation. Individuals should be free to acquire all types of assets (securities, real estate etc.) and must accept the risks and consequences of their actions either after undertaking sufficient due diligence themselves, or in reliance on the advice of others who have a duty of care.

A greater emphasis on disclosure would assist in providing assurance that investors were fully informed as to the nature and risks of a proposed investment. The provision of a risk factor disclosure document would lessen the reliance on any increase in the minimum exemption amount, as it would provide some assurance that potential investors were given a document that they were more likely to read than an offering memorandum, prospectus, or filings on SEDAR. Furthermore if a copy of the document was signed and retained by a dealer it would be of assistance in defending any allegation of misconduct or omission by the dealer.

The determinant of appropriateness of an investment for an individual investor should be based upon the suitability of the investment for the investor's individual goals and needs. We believe disclosure obligations should be enhanced with respect to exempt market products. This obligation properly lies with the offering advisor and firm. There are a number of SRO's plus 13 provincial and territorial regulatory bodies that currently provide guidance and govern the process of suitability assessment carried out by qualified and licensed advisors. It would appear appropriate to look to this framework to enhance a principals based approach to the sale of exempt products as a means of mitigating risk.

The obligations that apply to all dealer registrants under securities legislation, included in NI 31-103 and SRO Rules and Policies, include obligations to know your client, know your product and to act in good faith and deal fairly. It therefore seems appropriate to focus on enhancing this guidance as to the meaning of "suitable". Many of the tools used by dealers and their representatives to determine suitability of investments and

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what would be suitable for a particular investor are subjective in nature. For example, when an investor indicates they have a high risk tolerance, the obvious question is how high is high? Is suitability to be determined with respect to a single investment, or on a portfolio basis?

The CSA should consider the fact that investors' investments in aggregate, function to produce a consolidated outcome and should not be examined in isolation, except to the extent that the risk/return profile of the individual investment serves the objectives of the investors complete integrated portfolio in realizing their stated objectives for risk and return. In this context, diversification to reduce concentration of risk, should take priority over determining suitability based on any one particular risk metric, such as liquidity or volatility.

The CSA, provincial regulators and SROS should develop a harmonized approach to risk and should refrain from identifying all exempt markets as inherently risky unless it can provide evidence that is inclusive of all offerings in the exempt market. It follows that the CSA should attempt to stratify the exempt market as undoubtedly not all exempt market products are or should be classified with the same risk profile. A stratification of products would allow for more appropriate risk assessment and management by those that offer such products and would provide greater and more accurate disclosure for investors. The CSA should also consider how to approach the risk assessment of exempt products that are managed by independent, qualified registrants (e.g. IFMs, PMs). Registrant oversight and management for exempt products should be viewed as equally credible as that oversight provided by the same registrant for prospectus based products.

Alternatively, the CSA should focus on providing investor documents outlining the differences in disclosure and investor rights between an exempt investment and one offered by prospectus.

What due diligence obligations does a dealer or representative have to undertake to confirm that the assets the client says he or she owns actually exist and have the value as stated? We are hopeful that the CSA will agree that a statement of a client and/or the client's signature on a document can and should be relied upon by a dealer and its representatives, absence actual knowledge or a well reasoned belief to the contrary. If an individual certifies in writing a clear statement with regard to the individual's income, assets, position, risk tolerance, level of income, etc., it is unreasonable and unwarranted to require anything further.

We take issue with the concept that a prospectus in any significant manner protects investors given that it is unlikely that more than a few investors actually read the prospectus. While some comfort can be gained from the role of the underwriter in a prospectus offering, full, plain and true disclosure offers "protection", if defined very broadly, only if the prospectus is actually read.

As the effective regulation of all dealers and representatives distributing to investors who rely on the accredited investor and minimum purchase exemptions is relatively new, we suggest that the review of these exemptions be examined in the context of greater empirical data than what is available today. The level of knowledge and experience gained post the adoption of NI 31-103 is too limited to allow one to reasonably conclude

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that the obligations of all dealer registrants and their representatives are not sufficient in addressing the concerns of the CSA with regard to the reliance on the two exemptions in question. Furthermore, the CSA has provided no data or analysis, to date, comparing investor outcomes in the four provinces which allow access to exempt markets under the Offering Memorandum exemption, which only provides for the signing of a Risk Acknowledgement form as a barrier to access.

In conclusion, we would support the CSA continuing to gather empirical data and continuing the dialogue with stakeholders before assessing its course of action with respect to any changes to the current policy. We regard the determination of the appropriate framework for prospectus exempt offerings as a matter of broad public policy and it is of importance to the economy as a whole. We would prefer the CSA members to use their immediate resources to take a more active stance in improving their monitoring of and responsiveness to complaints in these markets where there is early suspicion of issuer fraud and misrepresentation as well as working with legislators in their respective provinces to improve mechanisms for investor restitution resulting from these failures. We believe all market participants deserve this type of protection and would fully support this direction and focus.

We want to thank the CSA for the opportunity to comment. Should you wish to discuss further with the Members of the Board of the Federation or any general members, do not hesitate to contact the undersigned.

Regards,

Federation of Mutual Fund Dealers

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