



February 29, 2012

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
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

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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Dear Sirs/Mesdames:

Re: Review of Minimum Amount and Accredited Investor Exemptions – Public Consultation

The Mutual Fund Dealers Association of Canada (“MFDA”) is the national self-regulatory organization (“SRO”) for mutual fund dealers. We are writing in response to your invitation to provide comments on CSA Staff Consultation Note 45-401 – Review of Minimum Amount and Accredited Investor Exemptions (“Consultation Note”) published on November 11, 2011.

We support the review by CSA staff of the minimum amount and accredited investor prospectus exemptions; however, we also believe that any changes made to these particular exemptions will

only address some of the issues with the current exempt market regime in Canada. Set out below are the concerns that we have identified with the exempt market dealer regime and the prospectus exemptions.

Concerns with Current Exempt Market Dealer Regime

EMD Registration Category not Harmonized across Canada

The exempt market registration regime is not harmonized across Canada and investors are currently subject to different levels of protection depending on where they reside. Individuals and firms in British Columbia, Alberta, Manitoba, the Northwest Territories, Nunavut, and the Yukon Territory can deal in the exempt market without registration, provided certain conditions are met. In these jurisdictions, individuals in the financial services industry, who are not licensed and not required to meet minimum proficiency requirements, may also sell exempt securities to their clients. Clients may not be aware or understand that such individuals are not registered under securities legislation and subject to the same regulatory obligations as securities registrants.

Exemption Conditions from EMD Registration

One of the conditions for relief from the requirement to register as an EMD in the western provinces and northern territories is that the person does not advise, recommend, or otherwise represent that the security being traded is suitable for the purchaser. We question the practicality of such a prohibition. It is difficult to envision a situation where the attributes and characteristics of an exempt security are discussed with a potential investor without an explanation as to how the security is suitable for the investor. The suitability obligation is a fundamental investor protection and not affording investors such a protection can have a significant impact.

Scope of Permitted Activity under EMD Registration

With respect to jurisdictions that require registration to deal in the exempt market, we have serious investor protection concerns with the scope of activity permitted under the EMD category of registration. In particular, our concerns relate to the ability of EMDs to trade in prospectus-qualified securities, including exchange-traded securities and mutual funds, with accredited investors. We note that when the accredited investor exemption was first published for comment several years ago, the proposal stated that the regulatory rationale for the exemption was to facilitate the raising of capital for small and medium size issuers (by avoiding the cost of a prospectus). This rationale does not apply to the sale of prospectus-qualified securities.

We are concerned that the broad scope of activity permitted for EMDs will result in regulatory arbitrage and negatively affect investor protection. By obtaining their EMD registration, individuals are able to hold themselves out as full-service financial product providers and sell the same products sold through mutual fund dealers and investment dealers without being subject to the same level of regulation and oversight by the MFDA or the Investment Industry Regulatory Organization of Canada (“IIROC”). We note that CSA staff recently acknowledged these issues in Staff Notice 31-327 – Broker-Dealer Registration in the Exempt Market Dealer Category in

relation to broker-dealer firms registered in the United States seeking EMD registration in Canada. CSA staff noted that it was not envisioned that EMDs would be involved in brokerage activities, including trading securities on an exchange. While CSA Staff Notice 31-327 was limited to identifying concerns with firms registered in the United States conducting brokerage activities, the same concerns apply equally to Canadian EMDs and to trading in all prospectus-qualified investments, including mutual funds.

Investors who meet the accredited investor exemption will not be subject to the same protection afforded to them had the activity been conducted through an SRO Member, including ongoing requirements to assess investment suitability and protection fund coverage. SRO Members are subject to more detailed requirements than non-SRO Members with respect to business conduct, supervision, and financial reporting. SRO Members may seek to take advantage of the permitted scope of EMD activity by focusing their business models on accredited investors in order to give up their mutual fund dealer or investment dealer registration and register as EMDs, thereby avoiding the costs associated with SRO membership and protection fund participation. The regulation of EMDs under NI 31-103 currently creates, to the detriment of the investing public, an un-level regulatory playing field between SRO Members and non-SRO Members that engage in the same activity.

Specific Issues with Prospectus Exemptions

Minimum Income and Net Worth Thresholds

Prospectus exemptions have been used to sell, to unsophisticated retail investors, complex, high risk and illiquid securities. The general growth of investor wealth has enabled a large number of retail investors to meet the minimum investment amount and net worth and income thresholds required for these exemptions. The size of the investment does not assure investor sophistication or access to information, particularly in respect of the sale of novel or complex securities that do not have accompanying disclosure.

Offering Memorandum Exemption

In the provinces that do not require EMD registration, under the offering memorandum exemption, exempt securities can be sold to anyone without a suitability review provided the purchaser receives and signs a risk disclosure document. We have concerns with placing the onus on retail investors to determine if the purchase of exempt securities is suitable for them through risk disclosure alone. In provinces where EMD registration and a suitability review is required, we are concerned that the risk disclosure document may serve to shift part of the responsibility for unsuitable trades to the investor. Disclosure documents and client acknowledgements are not effective investor protection alternatives to a suitability obligation under securities legislation.

Suitability

With respect to assessing suitability, we note that the role played by the SROs goes beyond establishing requirements. SROs provide ongoing guidance to their Members as to what these

requirements mean and how to comply with them. In addition, SROs perform regular, active oversight to ensure that these obligations are being met in the manner prescribed. Where the party selling exempt securities is not registered and subject to oversight, securities regulators may only become aware of the issues after the harm has occurred. Under the current minimum amount exemption, investors may purchase highly illiquid exempt securities that can represent a significant portion of the client's portfolio. In the event that such a security is later determined to be unsuitable, the client may have difficulty selling it on the secondary market or back to the issuer. In considering the overall impact to the investor, we believe that regulators need to be more proactive in addressing issues raised by prospectus exemptions rather than taking a reactive approach after harm has occurred.

General Comments

We support re-examining the minimum amount and accredited investor prospectus exemptions; however, we also believe that any changes made to these particular exemptions will only address some of the issues with the current exempt market regime in Canada. In our view, a greater underlying concern relates to opportunities for regulatory arbitrage that currently exist throughout the exempt market regime. Registration requirements for transacting in the exempt market are not harmonized across Canada. In jurisdictions that currently require registration to deal in the exempt market, the current scope of activity permitted under the EMD registration category in NI 31-103 creates, to the detriment of the investing public, an un-level regulatory playing field between SRO Members and non-SRO Members that engage in the same activity.

In our view, all transactions in exempt market securities should require the involvement of a registrant under securities legislation. We note that this would require reconsideration of the alternative approach to EMD regulation that has currently been adopted in certain jurisdictions. In addition, having regard to the concerns noted, we believe that EMDs should not have the ability to transact in prospectus-qualified securities.

Please do not hesitate to contact the undersigned should you have any questions or require further information.

Yours truly,



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General Counsel & Vice-President, Policy

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