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Special Supplement
Mutual Fund Dealers Association of Canada

NOTICE OF PROPOSED CHANGES
TO
PROPOSED RULE 31-506

SRO MEMBERSHIP - MUTUAL FUND DEALERS

Substance and Purpose of Proposed Rule

Background

The Commission published proposed Rule 31-506 SRO Membership - Mutual Fund Dealers for a 90-day comment period in October 1997.[1] The Commission published proposed changes to proposed Rule 31-506 in June 1998 for an additional 30-day comment period.[2]

Since 1997, the Commission, together with other members of the Canadian Securities Administrators (CSA), has encouraged and supported the establishment of the Mutual Fund Dealers Association of Canada (MFDA). The MFDA was created in June 1998 as a non-share capital corporation with an objective of acting as a self-regulatory organization for mutual fund dealers in Canada.

In December 1999, the MFDA submitted its application to the Commission for recognition as a self-regulatory organization for mutual fund dealers (SRO) under section 21.1 of the Act. Concurrently with releasing this Notice of Proposed Changes and proposed Rule 31-506, the Commission is publishing for a 90-day comment period:

- The proposed Criteria the Commission will use to assess the MFDA in determining whether to recognize the MFDA as a SRO for mutual fund dealers; and

- The response of the MFDA to the Commission's proposed Criteria for recognition.

The draft rules and by-laws of the MFDA are attached to the MFDA's response to the Commission's Criteria for recognition. The proposed Criteria, the MFDA response to the proposed Criteria and the draft rules and by-laws of the MFDA will be referred to in this Notice of Proposed Changes as the MFDA Recognition Package.

Commentators can submit comments on the proposed changes to the proposed Rule in the manner and within the time limits described in this Notice. Commentators can also submit comments to the Commission on its proposed Criteria, on the MFDA's response to the proposed Criteria and on the draft rules and by-laws of the MFDA in the manner and within the time limits described in the Notice published with the MFDA Recognition Package.

Substance and Purpose of Proposed Rule

The purpose of the proposed Rule is to address certain regulatory issues that arise in connection with regulatory oversight of mutual fund dealers. The proposed Rule requires all mutual fund dealers to be members of the MFDA once the MFDA is recognized by the Commission as a SRO for mutual fund dealers, within the times set out in the proposed Rule.

Mutual fund dealers who prefer to join the Investment Dealers Association of Canada (the IDA), the only SRO currently recognized by the Commission, will need to change their registration category to "investment dealer" or "securities dealer" and change their business and operations to meet the regulatory standards imposed on IDA members.

The proposed Rule does not propose any differentiation between the various companies registered as mutual fund dealers. For example, registrants that are registered as mutual fund dealers, but that carry on the principal business of acting as sponsor and manager of mutual funds, will be required to become members of the MFDA within the time limits established by the proposed Rule. These registrants should carefully examine the draft rules and by-laws of the MFDA to determine the effect of such rules on their business as mutual fund managers and sponsors. If these registrants do not wish to become members of the MFDA, they must change their business structures and surrender their registration as mutual fund dealers.

Similarly, mutual fund dealers or salespersons that are also licenced to sell insurance products or that offer financial planning services will be required to comply with the proposed Rule. The Commission is of the view that financial planning, as it is related to advising and trading in securities, should be directly regulated by the MFDA. The Commission acknowledges that MFDA membership will 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. To that end, the CSA staff working on the CSA financial planning initiative have involved Canadian insurance regulators in their work to review and harmonize the regulation of financial planners.

The proposed Rule conforms to the fundamental principle in paragraph 4 of section 2.1 of the Act under which the Commission should, subject to an appropriate system of supervision, use the enforcement capability and regulatory expertise of recognized self-regulatory organizations.

Further background to the proposed Rule is given in the Notices published with the October 1997 and June 1998 versions of the proposed Rule.

Summary of Proposed Rule

The proposed Rule will require all mutual fund dealers registered with the Commission in that registration category to

- become members of the MFDA once the MFDA is recognized by the Commission as a SRO for mutual fund dealers, by the end of one year and 30 days after the date the Commission recognizes the MFDA as a SRO for mutual fund dealers; and

- prepare and submit to the MFDA an Application for Membership in the form prescribed by the MFDA,

[1] (1997) 20 OSCB 5051.

[2] (1998) 21 OSCB 3875.

together with the MFDA's prescribed fees by certain specified deadlines.

Mutual fund dealers registered with the Commission on the effective date of the proposed Rule (anticipated to be January 1, 2001) will be required to file an Application for Membership and pay the MFDA's prescribed fees by January 31, 2001, assuming the Commission recognizes the MFDA as a SRO by January 1, 2001. Assuming the January 1, 2001 recognition date, these mutual fund dealers will be required to become members of the MFDA by January 30, 2002.

An applicant for registration as a mutual fund dealer after the effective date of the proposed Rule will be required to become a member of the MFDA also on January 30, 2002 if it became registered as a mutual fund dealer before such date. This means that a new applicant can become registered with the Commission as a mutual fund dealer if it meets securities legislative requirements before January 30, 2002, but it must become a member of the MFDA to continue to be a mutual fund dealer after that date. A new applicant will be required to file an Application for Membership with the MFDA and pay the prescribed fees on the same date as it files its application to the Commission for registration as a mutual fund dealer in order to be considered for registration as a mutual fund dealer. Any applicant for registration as a mutual fund dealer submitting its application after January 30, 2002 will not be registered unless and until it becomes a member of the MFDA.

The proposed Rule is expected to become effective on January 1, 2001, which is the date that the Commission is working towards recognizing the MFDA as a SRO for mutual fund dealers. The Director may grant an exemption under the proposed Rule upon the application of registrants experiencing particular circumstances that make compliance with the proposed Rule difficult.

Summary of Changes to the Proposed Rule

Commentators are invited to provide the Commission with comments on the proposed changes to the proposed Rule.

Section 1.1 is new. It provides for a definition of the term "MFDA" which is now necessary since the proposed Rule is specific in referring to the MFDA as the SRO to which each mutual fund dealer must become a member.

Section 2.1 of the proposed Rule was former section 1.1 in the October 1997 and the June 1998 versions of the proposed Rule. Section 2.1 now specifically refers to the MFDA as the SRO to which all mutual fund dealers must become members.

Part 3 is new and reflects the need for the MFDA, as the SRO for mutual fund dealers to receive an application for membership, in advance, from those mutual fund dealers wishing to become members of the MFDA.

Section 3.1 requires a mutual fund dealer which is a mutual fund dealer on the effective date of the proposed Rule to prepare and file an Application for Membership in the form prescribed by the MFDA and to pay the fees prescribed by the MFDA within thirty days of the date the Commission recognizes the MFDA as a SRO for mutual fund dealers. If the MFDA is recognized by the Commission on January 1, 2001, section 3.1 will require all existing mutual fund dealers to apply for membership with the MFDA and pay the prescribed fees by January 31, 2001.

The MFDA will make available its proposed Application for Membership, and details of the amount of the fee that will be levied upon filing of such Application through a public statement expected during the summer of 2000.

Section 3.2 deals with those persons or companies that are not registrants with the Commission as mutual fund dealers, but that apply for such registration after the effective date of the proposed Rule. Such a person or company must file an Application for Membership and pay the prescribed fees with the MFDA on the same date as it files its application for registration with the Commission.

Part 4 of the proposed Rule contains several changes from Part 3 of the June 1998 version of the proposed Rule:

- Section 4.1 clarifies that the proposed Rule will come into force on a date certain. The Commission anticipates that this date will be January 1, 2001, which is the date that the Commission is working towards recognition of the MFDA as a SRO for mutual fund dealers;

- Section 4.2 clarifies when section 2.1 of the proposed Rule will become effective for a registered mutual fund dealer. Mutual fund dealers will have effectively a maximum of one year and 30 days to become members of the MFDA; to January 30, 2002. The MFDA will drive the membership deadline for mutual fund dealers and will conduct membership reviews of mutual fund dealers in an orderly fashion.

- Former section 2.1 has been deleted since applicants for registration as mutual fund dealers after the effective date of the proposed Rule will be subject to the same rules as mutual fund dealers registered as such on the effective date of the proposed Rule, except as set out in section 3.2.

Authority for Proposed Rule

The following sections of the Act provide the Commission with authority to adopt the proposed Rule. Paragraph 143(1)1 of the Act authorizes the Commission to make rules prescribing requirements in respect of applications for registration and the renewal, amendment, expiration or surrender of registration. Paragraph 143(1)2 of the Act authorizes the Commission to make rules prescribing conditions of registration or other requirements for registrants or any category or subcategory of registrant.

Timing of the Rule

The Commission is working towards having the proposed Rule become effective on January 1, 2001. The time periods established by Parts 3 and 4 of the proposed Rule are different and shorter than contemplated in previous versions of the proposed Rule.

A mutual fund dealer that does not wish to become a member of the MFDA (assuming the MFDA is recognized as a SRO for mutual fund dealers by the Commission) must either surrender its registration or re-register as an investment dealer or a securities dealer and apply for membership with the IDA. The IDA has different requirements from the MFDA and a member of the IDA must conform to these different requirements.

Mutual fund dealers should begin to plan for the transition under this proposed Rule immediately. Mutual fund dealers should be aware that the processing of applications for membership by the MFDA requires adequate review and may take some time. The Director will have authority to grant exemptions from the proposed Rule and may also consider applications for temporary exemptions in certain circumstances.

Summary of Written Comments Received by the Commission

No comments were received by the Commission in respect of the first publication of the proposed Rule in October 1997. During the comment period on the June 1998 version of the proposed Rule, five comment letters were received:

1. Stikeman Elliott as counsel to The Independent Mutual Fund Dealers Committee, being a committee established to represent independent mutual fund distributors (the Committee). Stikeman Elliot explains that the Committee was "established to provide a mechanism whereby independent mutual fund distributors could speak with a unified voice on specific issues of interest to them to The Investment Funds Institute of Canada, regulators, mutual fund manufacturers and the public." No individual members of the Committee were identified in the comment letter nor does the comment letter indicate the number of mutual fund dealers that are members of the Committee.

2. The Investment Centre, a mutual fund dealer based in London, Ontario. The Investment Centre provides no additional comments, but refers to and supports the Committee's comment letter.

3. Keybase Financial Group, a mutual fund dealer based in Toronto, Ontario.

4. Regal Capital Planners Ltd., a mutual fund dealer based in Waterloo, Ontario.

5. HEWMAC Financial Group Limited, a mutual fund dealer based in Newmarket, Ontario.

The commentators uniformly supported the principle of self-regulation by mutual fund dealers, but point out what they term as fundamental flaws in the proposed structure of the MFDA. All commentators express concerns over the proposed structure of the MFDA, principally commenting that the MFDA does not provide adequate representation to independent mutual fund dealers. Instead the MFDA is governed and regulated by direct competitors of independent dealers such as banks, insurance companies and the IDA.

Counsel to the Committee points to the many benefits of SROs generally, noting that self-regulation can be more effective, flexible, cost-efficient and adaptive than direct regulation. However, the Committee is concerned that the MFDA is not "a proper or appropriate" SRO. The Committee is also concerned that the Commission's process is fundamentally flawed. Its reasons can be summarised as follows:

- *The MFDA is non-transparent and undemocratic*

Independent mutual fund dealers are not sufficiently represented to play a meaningful role and have their concerns properly addressed. The MFDA is dominated by The Investment Funds Institute of Canada (IFIC) and the IDA which have different interests than independent mutual fund dealers. There is no real representation by independent mutual fund dealers- only two of 21 board members are allocated to independent mutual fund dealers. An inappropriate governance structure is unlikely to take the differences between the independent mutual fund dealers and larger organizations into account when designing rules or determining which dealers are suitable for membership.

- *The Commission's process is flawed*

The comment period is being inappropriately hurried. Amendments to the Rule are necessary or alternatively legislative amendments are warranted in order to ensure that the proper benefits of a SRO can be achieved. It is premature to seek comments on the Rule as many details surrounding the MFDA are unknown. Without more information, it is impossible to comment meaningfully on the Rule. The Commission should withdraw the Rule and republish it for comment when there is a sufficient basis for comment or, alternatively, extend the comment period. The Commission has not considered the likely costs of the Rule. The Commission should explore expansion of the existing contingency trust fund. The quantum of fees is unknown. No public guidance has been provided as to the recognition criteria for the MFDA.

- *The Commission lacks jurisdiction*

The Commission does not have jurisdiction to require membership in a **recognized** SRO, as opposed to a SRO generally. If the Commission has the power to compel membership in a SRO and to increase requirements applicable to members of a SRO by altering its rules, the Commission would in effect have the power to increase regulatory requirements without being subject to the safeguards of the rule-making process. In circumstances where membership is compelled, any higher standards should be adopted voluntarily by a SRO. Compulsory membership in what should be a voluntary organization "would turn the concept of a voluntary SRO on its head". The Commission is the driving force behind the MFDA and is forcibly creating it. The Committee recommends deletion of the concept of recognition of the SRO from the Rule. Alternatively, the Committee recommends legislative amendment to clarify the issue. It is not open to the Commission to forcibly create an organization that does not represent registrants (given the definition in the *Securities Act* stating that a SRO "represent registrants") and then require registrants to become members of it, since it would appear that it must represent registrants before it could become a SRO.

- *The Commission is focussed on incorrect issues*

The Commission has suggested that the MFDA is necessary because of unscrupulous practices of mutual fund dealers. If there are compliance concerns, the appropriate response is the use of the Commission's substantial compliance and enforcement powers.

- *Other comments*

The Committee recommends a SRO which has a fully national approach and which regulates similar products. At minimum, any Rule should have a "sunset" clause to require this matter to be reconsidered within not more than three years. Section 2.1 of the Rule indicates that the Rule will be effective on a specified date, apparently six months after the Rule comes into effect, for applicants for registration while section 2.2 indicates that it will be effective on a specified date, apparently 18 months after the Rule comes into effect for renewals of registration. This could create inappropriate results for members undergoing reorganization. An effective date treating all members equally might be preferable.

The other commentators reiterate the comments of the Committee, particularly the assertions that the MFDA will not provide adequate representation to independent mutual fund dealers and that it is premature to be seeking comments on the proposed Rule given that the rules of the MFDA are unknown. Without knowledge of these rules, the Commission cannot have properly assessed the full costs of the MFDA. These commentators are of the view that independent mutual fund dealers are structured and operate differently than IDA member brokers and/or bank operated mutual fund dealers and accordingly these mutual fund dealers should be given a greater voice in the governance of the MFDA.

The Commission has considered these comments carefully and note that many of the questions of the commentators will be addressed as they review the MFDA Recognition Package. Comments on the MFDA Recognition Package can be provided within the time limits as described in the Notice to the MFDA Recognition Package. The Commission will consider comments on the governance structure of the MFDA in response to the MFDA Recognition Package.

The Commission notes that many of the comments on the June 1998 version of the proposed Rule are not comments on the proposed Rule per se, but are comments on the perceived drawbacks of the MFDA. As noted above, commentators should review carefully the MFDA Recognition Package and provide their comments in respect of those documents, if they continue to have concerns about the MFDA.

Comments to the effect that the Commission was "rushing" the comment process on the proposed Rule and that commentators could not be expected to properly comment on the proposed Rule since the proposed rules of the MFDA were not known, are being addressed through this additional publication of the proposed changes to the proposed Rule and through the publication of the MFDA Recognition Package.

The Commission considers that it has appropriate jurisdiction to make the proposed Rule.

Alternatives Considered

The Commission considers increased reliance on the self-regulatory system to be consistent with the purposes of provincial securities legislation and rejected the option of retaining the status quo. SROs can bring industry expertise to bear on members and can apply uniform standards on a consistent basis across provincial boundaries. They can react faster than a government agency to changes in market conditions and to activities of concern. No alternatives other than retaining direct regulation of mutual fund dealers were considered.

Unpublished Materials

In proposing the Rule, the Commission has not relied on any significant unpublished study, report or other material.

Anticipated Costs and Benefits

There are substantial benefits involved in a self-regulatory organization system of regulation. A self-regulatory organization system helps to ensure compliance with regulatory requirements and also helps to provide consistent application and interpretation of the regulatory requirements.

Clients of affected mutual fund dealers will benefit from the protections afforded by the MFDA and a SRO system and the availability of a dealer funded contingency fund as mutual fund dealers are not currently required to be members of a SRO and do not currently contribute to a dealer funded contingency fund.

The proposed Rule will impose costs on mutual fund dealers as they are not currently members of a SRO and do not currently contribute to a dealer funded investor compensation fund. These costs will include fees for membership in the MFDA as well as the levies of a compensation fund. Mutual fund dealers may be required to change their business and affairs to ensure compliance with the rules of the MFDA.

The Commission believes that the benefits of the proposed Rule justify the costs.

Comments

Interested parties are invited to make written submissions with respect to the proposed changes to the proposed Rule.

Submissions received by July 17, 2000 will be considered.

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

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

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

Questions may be referred to:

William R. Gazzard
Director, Capital Markets
Ontario Securities Commission
(416) 593- 8089
Email: wgazzard@osc.gov.on.ca

Rebecca Cowdery
Manager, Investment Funds
Capital Markets
Ontario Securities Commission
(416) 593-8129
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(416) 595-8915
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Proposed Rule

The text of the proposed Rule follows, together with footnotes that are not part of the Rule but have been included to provide background and explanation.

Dated: June 16, 2000.

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ONTARIO SECURITIES COMMISSION RULE 31-506
SRO MEMBERSHIP - MUTUAL FUND DEALERS[1]

PART 1 DEFINITIONS

1.1 Definitions - In this Rule

"MFDA" means the Mutual Fund Dealers Association of Canada, a self-regulatory organization for mutual fund dealers[2] recognized by the Commission under section 21.1 of the Act.

PART 2 MEMBERSHIP REQUIRED

2.1 Membership Required - A mutual fund dealer shall be a member of the MFDA.

PART 3 APPLICATION FOR MEMBERSHIP

3.1 Mutual Fund Dealers on Effective Date

(1) A mutual fund dealer which is a mutual fund dealer on the effective date of this Rule shall file, within the time period established by subsection (2), with the MFDA:

(a) an application for membership in the form prescribed by the MFDA; and

(b) the fees prescribed by the MFDA for the application for membership.

(2) A mutual fund dealer referred to in subsection (1) shall file the application for membership and the fees referred to in subsection (1) within thirty days after the date the Commission recognizes the MFDA as a self-regulatory organization under section 21.1 of the Act.[3]

3.2 New Applicants for Registration as Mutual Fund Dealers

(1) A person or company that applies to the Commission for registration as a mutual fund dealer shall file with the MFDA:

(a) an application for membership in the form prescribed by the MFDA; and

(b) the fees prescribed by the MFDA for the application for membership

on the same date as it files its application for registration with the Commission as a mutual fund dealer.

PART 4 EFFECTIVE DATE

4.1 Effective Date for Rule - This Rule shall come into force on **3**, 2001[4].

4.2 Effective Date of Section 2.1 for Mutual Fund Dealers - Despite section 4.1, section 2.1 shall be effective for a mutual fund dealer on the day that is one year and thirty days after the date the Commission recognizes the MFDA as a self-regulatory organization for mutual fund dealers under section 21.1 of the Act.[5]

PART 5 EXEMPTION

5.1 Exemption - The Director may grant an exemption to this Rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

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1 This is the third publication of proposed Rule 31-506, which was first published for comment on October 3, 1997 at (1997) 20 OSCB 5051. Once made final, proposed Rule 31-506 will be a local rule of the Commission.

2 The term "mutual fund dealer" is defined in Rule 14-501 Definitions as "a person or company registered under the Act in the category of mutual fund dealer".

3 The MFDA has asked the Commission to recognize it as a self-regulatory organization under section 21.1 of the Act by January 1, 2001. Mutual fund dealers who are so registered on the effective date of this Rule (expected to be January 1, 2001) will be required to file with the MFDA an application for membership and pay the prescribed fees by January 31, 2001.

4 The Commission expects this date to be January 1, 2001. The date the Commission recognizes the MFDA as a self-regulatory organization under section 21.1 of the Act will be coordinated with the effective date of this Rule. Both dates are expected to be the same date.

5 Assuming the MFDA is recognized as a self-regulatory organization on January 1, 2001, section 2.1 of this Rule will become effective on January 30, 2002. Any person or company that is registered as a mutual fund dealer as of January 31, 2002, but that is not a member of the MFDA will be in breach of this Rule and will not be permitted to carry on business as a mutual fund dealer.

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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.

[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.

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

[2] (1999) 22 OSCB 5258.

[3] (1999) 22 OSCB 7669.

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
Director, Capital Markets
Ontario Securities Commission
(416) 593- 8089
wgazzard@osc.gov.on.ca

Rebecca Cowdery
Manager, Investment Funds
Capital Markets
Ontario Securities Commission
(416) 593-8129
rcowdery@osc.gov.on.ca

Elle Koor
Senior Accountant, Compliance
Capital Markets
Ontario Securities Commission
(416) 593-8077
ekoor@osc.gov.on.ca

Jennifer Elliott
Legal Counsel, Market Regulation
Capital Markets
Ontario Securities Commission
(416) 593-8109
jelliott@osc.gov.on.ca

Tamara Hauerstock
Legal Counsel, Investment Funds
Capital Markets
Ontario Securities Commission
(416) 595-8915
thauerstock@osc.gov.on.ca

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

PROPOSED CRITERIA FOR RECOGNITION OF A SELF-REGULATORY ORGANIZATION FOR MUTUAL FUND DEALERS BY THE ONTARIO SECURITIES COMMISSION

Introduction

Ontario securities legislation defines a SRO as a body that represents registrants, is organized for the purpose of regulating the operations and standards of practice and business conduct of members and regulates members with a view to promoting the protection of investors and the public interest.[1] The securities industry in Canada has endorsed self-regulation, with appropriate regulatory oversight, as being the most effective way to both regulate the distribution of securities and protect the public interest.

The Ontario Commission has developed criteria by which it will assess an applicant for recognition as a SRO for mutual fund dealers. The Ontario Commission's role includes:

(i) establishing the recognition process by which the SRO will be recognized as a SRO for mutual fund dealers;

(ii) approving the by-laws, rules and standards of the SRO;

(iii) overseeing the activities of the SRO; and

(iv) providing a right of recourse to SRO members and other affected persons with respect to the manner in which the SRO exercises its powers.

This model of self-regulation is similar to those applicable to other SROs, such as the Investment Dealers Association of Canada, and the Montreal, Toronto and the CDNX Stock Exchanges.

In order to fulfill its self-regulatory responsibilities, a SRO for mutual fund dealers will exercise its jurisdiction over members and their personnel in several contexts, including initial application for membership and/or approval, monitoring of compliance with the rules of the SRO on an ongoing basis, and, investigating as to compliance and taking enforcement action to require compliance or impose discipline.

Self-regulation will work well only if members of an industry believe they have a real responsibility for carrying out self-regulatory activities. The initiative to establish a SRO for mutual fund dealers seeks to achieve a structure under which the industry takes primary carriage of much of the work of regulation, with the Ontario Commission overseeing such work to ensure that it is effective.

The proposed criteria that will be applied to the initial recognition of the MFDA as a SRO for mutual fund dealers focus on a number of areas. Each of those areas is

1 Subsection 1(1) of the *Securities Act* (Ontario), R.S.O. 1990, c.S.5.

discussed below. The MFDA's response to each criterion is published in the following documents. Comments are invited on both the Criteria and the MFDA's response.

Recognition Criteria

In order to be recognized as a SRO for mutual fund dealers, the MFDA will have to satisfy certain initial criteria. Through the recognition criteria, the Ontario Commission will require that it fulfils each of the criteria set out below:

(i) that non-industry or public representatives are on the governing body and key committees;

(ii) that the governance structure promotes the primacy of public interest goals;

(iii) that the MFDA's membership, rule-making and disciplinary processes are fair and transparent;

(iv) that the MFDA's rules do not unnecessarily inhibit competition;

(v) that the staff of the MFDA, and other resources available to the MFDA, have the expertise and resources needed for effective supervision, monitoring and enforcement;

(vi) that facilities exist to ensure that complaints of investors are acknowledged and pursued; and

(vii) that, where the MFDA's rules differ from the rules applicable to other Canadian SROs, adequate justification for such differences exist due to the nature of the business of the members of the MFDA.

Generally, the proposed criteria for recognition of the MFDA as an SRO have been adapted from the criteria for recognition of the IDA as a SRO published in June 1995 (18 OSCB 2667) and the TSE Protocol dated October 23, 1997 published in the OSCB November 7, 1997.

In order to be recognized the MFDA must establish to the satisfaction of the Ontario Commission that it fulfills each of the criteria set out below:

STATUS

1. It is a "self-regulatory organization" as defined in the applicable securities legislation, it is organized for the purposes set forth therein and its rules are binding on its members.

2. It is non-profit.

Constating documents, by-laws, procedures, policies, and other related materials will be filed in support of this determination.

GOVERNANCE AND STRUCTURE

3. (a) Its arrangements with respect to the appointment, removal from office and functions of the persons ultimately responsible for making or enforcing the rules of the MFDA, namely the Board of Directors, (the Board) are such as to secure a proper balance between the interests of the different members of the MFDA, and in recognition that the protection of the public interest is a primary goal of the MFDA, an appropriate proportion of directors consist of persons representing the public.

(b) Without limiting the generality of the foregoing, the MFDA's governance structure reflects the agreement between the IDA and The Investment Funds Institute of Canada ("IFIC") in respect of the establishment of the MFDA and provides for:

(i) the rights of the IDA and IFIC to each nominate an equal number of members of the Board;

(ii) a nominating committee of the Board whereby the remaining directors, who would be independent from the securities industry, and who would represent the public, would be nominated;

(iii) an executive committee;

(iv) equal representation by nominees of the IDA, IFIC and the public directors on key MFDA committees, including the executive committee;

(v) appropriate qualifications, remuneration and conflict of interest provisions for directors and appropriate limitation of liability and indemnification protections for directors, officers and employees of the MFDA generally; and

(vi) a chairman, president, chief executive officer, chief operating officer, persons responsible for the functions of senior compliance officer, senior policy officer and senior enforcement officer and other officers, all of whom, except for the chairman, are independent of any member.

FEES

4. (a) The MFDA has sufficient means of raising revenues from its members to satisfy its responsibilities.

(b) Fees imposed by the MFDA on its members are equitably allocated and bear a reasonable relation to the costs of regulating such members. Fees do not have the effect of creating barriers to membership, and fees are organized in such a manner that they do not discourage increased capital, provided that fees may be based on assets under administration, member revenues, number of employees, use of services, actual costs incurred or other reasonable parameters.

(c) The costs of the operations of the MFDA will be borne by industry participants, through fees or other levies and will ensure the MFDA Protection Plan will be adequately funded.

MEMBERSHIP

5. The MFDA's rules permit all properly registered dealers who satisfy the membership criteria to become members thereof and provide for the non-transferability of membership. The MFDA's membership criteria provide for:

(a) reasonable financial and operational requirements, including minimum capital and capital adequacy, adequate debt subordination arrangements, protection fund participation in the MFDA Protection Plan, bonding and insurance, record-keeping, new accounts, knowledge of clients and suitability of trades, supervisory practices, segregation and protection of clients' funds and securities, the operation of accounts, risk management and internal control procedures, compliance procedures (including a written compliance program), client statements, settlements, order taking, order processing, account inquiries, confirmations and other back office requirements generally;

(b) reasonable proficiency requirements (including training, education and/or experience) with respect to partners, directors, officers, employees and agents;

(c) consideration of ownership of the applicant under the criteria established for purposes of paragraph 6 hereof;

(d) consideration of discipline history, including breaches of applicable securities laws, the rules of other self regulatory organizations, or MFDA rules, prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally of the applicant and any partners, directors and officers, in order that membership may, where appropriate, be refused where any of the foregoing have previously engaged in improper conduct, and shall be refused where the past conduct of any of the foregoing affords reasonable grounds for belief that the applicant's business would not be conducted with integrity; and

(e) reasonable consideration of relationships with other members and other business activities to ensure the appropriateness thereof.

Membership will also be subject to other considerations, including permitted distribution structures as outlined in the CSA Distribution Structures Committee Position Paper published in August 1999 (22 OSCB 5259) (the "Distribution Structures Paper").

Staff will determine whether or not the MFDA's membership requirements are such that they create anti-competitive barriers to entry into the industry and whether those rules

ensure that members are properly qualified to participate in the industry.

OWNERSHIP (AND CHANGES OF OWNERSHIP) OF MEMBERS

6. The MFDA's rules require prior MFDA approval to acquire a material registered or beneficial ownership interest in securities, indebtedness or other ownership interests in members, directly or indirectly, to become a transferee of such interests, and in respect of business combinations, mergers, amalgamations, redemptions or repurchases of securities, dissolutions and acquisitions of assets. Each case is subject to appropriate exceptions in the case of publicly traded securities, de minimis transactions that do not involve changes in de facto or legal control or the acquisitions of material interests or assets, and non-participating indebtedness. The MFDA rules also provide for approval in respect of all persons who satisfy criteria providing for:

   (a) consideration of discipline history, including breaches of applicable securities laws, the rules of other self regulatory organizations, or MFDA rules, prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally, in order that approval may, where appropriate, be refused where the person or company or any of its partners, directors or officers have previously engaged in improper conduct, and shall be refused where the past conduct of any of the foregoing affords reasonable grounds for belief that the business would not be conducted with integrity;

   (b) reasonable consideration of relationships with other members and other business activities to ensure the appropriateness thereof; and

   (c) refusal of approval in the absence of agreement to submit to the jurisdiction of the MFDA and to comply with its rules, to notify the MFDA of any changes in his, her or its relationship with the member or of any involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or in civil proceedings involving business conduct or alleging fraudulent conduct or deceit thereafter, to accept service by mail in addition to any other permitted methods of service, to authorize the MFDA to cooperate with other regulatory and self-regulatory organizations, including sharing information with these organizations, and to provide the MFDA with such information as it may from time to time request and full access to and copies of any and all records.

APPROVED PERSONS

7. The MFDA's rules require a member to confirm with the MFDA that persons that it wishes to sponsor, employ or associate with as a partner, director, officer or salesperson of a member (collectively, "Approved Persons") comply with applicable securities legislation and are properly registered.

The relationships between MFDA members and their Approved Persons will be limited according to permitted distribution structures as outlined in the Distribution Structures Paper.

DISCIPLINE OF MEMBERS AND APPROVED PERSONS

8. The rules of the MFDA provide that its members and their Approved Persons shall be appropriately disciplined for violations of applicable securities laws and of the rules of the MFDA. The rules of the MFDA provide for discipline to include censure, fine, suspension, bar, expulsion, limitation of activities, payment of costs and any other appropriate sanctions. The Ontario Commission shall be forthwith notified of any and all disciplinary proceedings following the issuance of a notice of hearing, and of the disposition of any and all disciplinary proceedings and of all settlements. Automatic or summary intervention shall apply where necessary to protect investors, clients, creditors, members, the MFDA Protection Plan or the MFDA.

9. The rules of the MFDA enable it to prevent the resignation of a member from the MFDA from becoming effective if the MFDA considers that any matter affecting the member, or any registered or beneficial holder of an ownership interest in securities, indebtedness or other ownership interests in members, directly or indirectly (and persons or companies associated or affiliated therewith), or members' Approved Persons, should be investigated or that the member or any such person or company should be disciplined.

10. Members will be subject to the review, enforcement and disciplinary procedures of the MFDA. MFDA staff will also review the activities of the personnel of MFDA members (partners, directors, officers and salespersons). Although members will be responsible for the conduct of all their personnel (whether approved and/or registered), personnel who are not required to be approved or registered will not generally be subject to the MFDA's enforcement jurisdiction.

DUE PROCESS

11. The rules of the MFDA relating to admission to membership, the imposition of limitations or conditions on membership and denial of membership are fair and reasonable, including in respect of notice, an opportunity to be heard or make representations, the keeping of a record, the giving of reasons and provision for appeals.

12. The rules of the MFDA relating to the discipline it exercises over members and Approved Persons are clear, fair and reasonable, including provisions regarding what constitutes misconduct, notice, an opportunity to be heard or make representations,

utilizing independent hearing officers, the keeping of a record, the giving of reasons and provision for appeals, provided that they shall provide for summary and/or automatic suspension in specified circumstances where necessary to protect investors, members, the MFDA Protection Plan or the MFDA, with a prompt right to a hearing after any summary and/or automatic suspension. The rules of the MFDA provide that the public is to be given notice of disciplinary matters (including, for greater certainty, proposed settlements) not less than 14 days prior to the date of the hearing in respect thereof (with names and a summary of facts); hearings shall be open to the public (except where required for the protection of confidential matters); and that the disposition of the matter including settlements is made public.

13. All decisions of the MFDA and its Board of Directors, regional councils or other committees with respect to members and their personnel will be subject to hearing and review by the Commission. Staff of the Ontario Commission will monitor the enforcement proceedings of the MFDA by way of receipt of regular reports and, on request, disclosure of the facts and circumstances of particular cases.

INFORMATION, REPORTING AND OTHER REQUIREMENTS APPLICABLE TO MEMBERS

14. Without limiting the generality hereof, the rules of the MFDA seek, at a minimum:

(a) to require that each member must at all times provide the MFDA with any and all information requested by it concerning the member's activities and full access to and copies of any and all records in respect thereof and authorize the MFDA to cooperate with other regulatory and recognized self-regulatory organizations;

(b) to ensure that the requirements of paragraphs 5, 6 and 7 are satisfied both initially and on an ongoing basis, including with respect to sub-paragraph 5(a) by the provision on an ongoing basis of audited annual and unaudited interim financial reports, capital reports and management letters and other appropriate information to the MFDA;

(c) to provide for an adequate early warning reporting system to alert the MFDA to possible financial problems at members and a system to alert the MFDA of other operational or financial difficulties that could adversely affect investors, clients, creditors, members, the MFDA Protection Plan or the MFDA, including requirements for a member's auditor to report material breaches of MFDA rules concerning, at a minimum, the calculation of the member's financial position, the member's handling and custody of money and securities and the maintenance of adequate records by the member;

(d) to provide for immediate reporting to the MFDA by members of risk-adjusted capital deficiencies and/or their failure to properly maintain their books and records;

(e) to require members to reconcile segregated securities and report to the MFDA thereon on a quarterly basis;

(f) to require members to provide to clients upon request their most recent statements of their financial summary;

(g) to prevent improper use and dissemination of confidential information respecting investors; and

(h) to prohibit the use of improper sales literature and, if and where appropriate, to monitor or regulate the use of sales literature generally.

Staff will determine if the MFDA's reporting requirements are adequate for their purposes without being unduly intrusive.

PURPOSE OF RULES

15. (a) The rules of the MFDA are designed:

(i) to ensure compliance with applicable securities laws;

(ii) to prevent fraudulent and manipulative acts and practices and to promote the protection of investors, just and equitable principles of trade and high standards of operations, business conduct and ethics;

(iii) generally to promote public confidence and public understanding of the goals and activities of the MFDA, to educate the public about mutual fund investment generally and to improve the competence of members and their Approved Persons;

(iv) to standardize industry practices where appropriate for investor protection;

(v) to permit the MFDA to review the financial service activities, that are not subject to another regulatory regime, conducted by its members;

(vi) to provide for the administration of the affairs of the MFDA; and

(vii) for such other purposes as may be approved by the Ontario Commission;

and shall not:

(viii) permit unfair discrimination among investors, mutual funds, members or others; or

(ix) impose any burden on competition that is not appropriate in furtherance of the above purposes.

(b) Unless otherwise approved by the Ontario Commission, the rules of the MFDA governing the carrying on of mutual fund distribution business by its members afford investors protection at least equivalent to that afforded by the relevant securities laws, provided that, for greater certainty, higher standards in the public interest are permitted and encouraged.

Staff will ascertain whether the MFDA's rules address those issues which are appropriate for the proper regulation of MFDA members and their representatives.

RULE-MAKING

16. No new rules or changes to rules (which shall include any revocation in whole or in part of a rule) shall be made effective by the MFDA without prior approval of the Ontario Commission and any such rules or changes shall be justified by reference to the permitted purposes thereof (having regard to paragraph 13 hereof) and shall be subject to a memorandum of understanding between the Ontario Commission and the MFDA ("Protocol") to be established regarding the review and approval of by-laws, rules, regulations, policy statements and amendments thereto. The Protocol shall cover when the Ontario Commission will require new rules or changes to rules to be published for comment.

17. Prior to proposing a rule or rule change, the board of directors of the MFDA shall have determined that the entry into force of such rule or rule change would be in the public interest and every proposed rule and rule change must be accompanied by a statement to that effect.

Staff will determine if the MFDA's rule making procedures are transparent and open to input from the industry, the public and government regulators.

OPERATIONAL ARRANGEMENTS AND RESOURCES

18. (a) The MFDA has adequate arrangements and resources for the effective monitoring and enforcement of compliance with applicable securities laws and with its rules. With the consent of the Ontario Commission, the arrangements for monitoring may make provision for one or more parts of that function to be performed on behalf of the MFDA (and without affecting its responsibility) by any other body or person who is able and willing to perform it. The Commission's consent may be varied or revoked from time to time and may be subject to terms and conditions.

(b) The MFDA can respond promptly and effectively to public inquiries and generally has effective arrangements for the investigation of complaints (including anonymous complaints) against its members or their approved persons. Such arrangements may make provision for one or more parts of that function to be performed on behalf of the MFDA (and without affecting its responsibility) by any other body or person who is able and willing to perform it, with the consent of the Ontario Commission, which consent may be varied or revoked from time to time and may be subject to terms and conditions.

(c) The arrangements and resources referred to in sub-paragraphs (a) and (b) above consist at a minimum of:

(i) sufficient qualified staff, including professional and other appropriately trained staff;

(ii) an adequate supervisory structure;

(iii) adequate management information systems;

(iv) a compliance department and an enforcement department, each with appropriately trained staff and with appropriate reporting structures directly to senior management, and, in the case of the compliance department, both regular examination and surprise examination procedures, and all such procedures shall be in writing wherever practicable;

(v) procedures and structures that minimize or eliminate conflicts of interest at the MFDA;

(vi) procedures to gather information on market practices;

(vii) inquiry and complaint procedures and a public information facility, including with respect to the discipline history of particular persons or companies;

(viii) guidelines regarding appropriate disciplinary sanctions; and

(ix) the capacity and expertise to hold disciplinary hearings (including regarding proposed settlements) utilizing independent hearing officers.

(d) A satisfactory review by or on behalf of the Ontario Commission of the arrangements and resources referred to in sub-paragraphs (a) through (c) above shall precede any recognition.

Staff will determine if the MFDA's locally deployed resources are sufficient to handle properly those functions that are to be performed locally, and that its national resources are sufficient to handle all the tasks that it has undertaken as a recognized SRO.

GENERAL AND DEFINITIONS

19. The MFDA is able and willing to cooperate, by the sharing of information and otherwise, with the MFDA Protection Plan, the Ontario Commission and its staff, and other Canadian federal, provincial and territorial recognized self-regulatory organizations and regulatory authorities, including without limitation those responsible for the supervision or regulation of securities firms, financial institutions and competition matters.

20. The information contained in the application for recognition shall be certified true, complete and correct by at least two duly authorized officers of the MFDA, and shall be approved by the MFDA's board of directors before being submitted to the Ontario Commission.

21. For the purposes hereof:

"independent" means independent according to criteria established for the purpose in question by the MFDA that are satisfactory to the Ontario Commission; and

"rules" mean the MFDA's Constitution, By-laws, Regulations, Policies, Forms, guidelines and other instruments.

PROPOSED TERMS AND CONDITIONS (CONTINUING OBLIGATIONS)

1. The MFDA shall enforce, as a matter of contract, compliance by its members and their Approved Persons with the rules of the MFDA, without prejudice to any action by the Ontario Commission under applicable securities laws.

2. The MFDA shall provide the Ontario Commission and the MFDA Protection Plan with prompt notice of material cases and reportable conditions, and the MFDA shall promptly advise the Ontario Commission when any member has failed to file on a timely basis any required financial, operational or other report. The Ontario Commission shall be notified forthwith of the triggering of all early warning thresholds which would reasonably be expected to raise concerns about a member's liquidity, risk-adjusted capital or profitability, and on a quarterly basis of the triggering of all early warning thresholds which did not raise such concerns, and in each case the Ontario Commission shall be advised of the circumstances and the MFDA's response thereto, together with the identity of the member in the former case.

3. The MFDA shall promptly report to the Ontario Commission misconduct or apparent misconduct by members and their Approved Persons and others where investors, creditors, members, the MFDA Protection Plan or the MFDA may reasonably be expected to suffer serious damage as a consequence thereof, including where the solvency of a member is at risk, fraud is present or there exist serious deficiencies in supervision or internal controls. In addition, the MFDA must advise the Ontario Commission promptly following the taking of any action by it with respect to any member in financial difficulty.

4. The Ontario Commission shall be notified as soon as practicable and not less than 14 days prior to the date of any disciplinary or settlement hearing, and the public and media shall be advised thereof by way of press release not less than 14 days prior to the date of any such hearing. In each case, the names of the member and relevant Approved Persons together with a summary of the circumstances shall be provided. In addition, the MFDA shall maintain a register summarizing such information which shall be available to the public.

5. The Ontario Commission shall be forthwith notified of the disposition of all disciplinary actions and settlements, and on a monthly basis of the status of all new investigations (indicating the date the investigation started and a summary of the conduct allegedly involved). The MFDA shall provide to the Ontario Commission annually or more frequently upon request a summary of the status of all investigations (indicating the date the investigation started, a summary of the conduct involved and the current status). In addition, the MFDA shall keep a record of all complaints (including anonymous complaints) and shall provide to the Ontario Commission annually or more frequently upon request a summary of all complaints and the disposition thereof, together with an analysis of any emerging problems or trends. The MFDA shall not refrain from investigating complaints due to the anonymity of the complainant where the complaint is otherwise worthy of investigation and sufficiently detailed to permit investigation. The MFDA shall at least annually review all material settlements involving its members and their investors with a view to determining whether any action is warranted, and the MFDA shall preclude members from imposing confidentiality restrictions on clients vis-a-vis the MFDA, whether as part of a resolution of a dispute or otherwise.

6. The MFDA shall maintain its ability to perform its self-regulatory functions, including those specified in paragraph 16 of the Recognition Criteria, and shall advise the Ontario Commission at least annually of its self-regulatory staff complement, by function, and of any material changes or reductions in self-regulatory staff, by function.

7. The MFDA shall advise the Ontario Commission in advance of any proposed material changes or reductions in its financial audit or operational and sales compliance review programmes, including as to procedures or scope, of any proposed changes in its external audit instructions and of any proposed material changes or reductions in the operation of its investigation or enforcement programmes.

8. The MFDA shall cooperate and assist with any surprise, regular or other reviews of its self-regulatory functions by the MFDA Protection Plan and/or the Ontario Commission. In addition, in the event that the Ontario Commission is of the view that there has been a serious apparent failure in the MFDA's fulfilment of its self-regulatory functions, the MFDA shall upon the request of the Ontario Commission undergo an independent third party review on terms and by a

person or persons satisfactory to or determined by the Ontario Commission, which review shall be at the expense of the MFDA, provided that where appropriate such reviews shall be conducted by or on behalf of the MFDA Protection Plan.

9. The MFDA shall provide the Ontario Commission with an annual report and with such information regarding its affairs, financial and other, as may be requested from time to time. The annual report shall be in such form as may be specified by the Ontario Commission from time to time.

10. Management of the MFDA shall at least annually self-assess the MFDA's performance of its self-regulatory responsibilities and report thereon to the executive committee, together with any recommendations for improvements. The executive committee shall be responsible for reporting to the Board as to the MFDA's performance of its self-regulatory responsibilities. The MFDA shall provide the Ontario Commission with copies or summaries of such reports and advise the Ontario Commission of any proposed actions arising therefrom.

11. The MFDA shall provide its budget and audited financial statements to the Ontario Commission on an annual basis following adoption thereof, and with such other information as the Ontario Commission may reasonably request.

12. The MFDA shall comply with paragraphs 14 and 15 of the Recognition Criteria with respect to making, amending and revoking rules.

13. The MFDA shall not make fundamental changes to its organizational structure, including, without limitation, those conditions set out in paragraphs 1, 2 and 3 of the Recognition Criteria, which would affect its self-regulatory functions without prior approval of the Ontario Commission, and shall give the Ontario Commission notice of new directors, officers and committee chairpersons, including a 5 year employment history and information as to prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings and civil proceedings involving business conduct or alleging fraudulent conduct or deceit in respect of each such person.

14. The MFDA shall cooperate, by the sharing of information and otherwise, with the MFDA Protection Plan, the Ontario Commission and its staff, and other Canadian federal, provincial and territorial recognized self-regulatory organizations and regulatory authorities, including without limitation those responsible for the supervision or regulation of securities firms, financial institutions and competition matters.

15. A copy of all written notices to members shall be provided to the Ontario Commission.

16. The MFDA shall wherever practicable document its interpretations of its rules and distribute them to its members and the Ontario Commission.

17. The MFDA shall immediately advise each other self-regulatory organization to which a member is subject of any breach or apparent breach of the rules thereof of which the MFDA becomes aware.

18. The MFDA shall ensure that it is accessible to the public and shall designate and make public the names and telephone numbers of persons to be contacted for various purposes, including complaints and enquiries.

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FOR PUBLICATION

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

Association canadienne des courtiers de fonds mutuels

("the MFDA")

Description of the Structure and Self-Regulating Activities of the MFDA:

For use in the development of the MFDA and the application of the MFDA as a recognized self-regulatory organization.

June 9, 2000

CONTENTS

PART I - INTRODUCTION

The MFDA

In 1997 the Canadian Securities Administrators ("CSA") requested the mutual fund industry to develop a regulatory structure that would address certain concerns identified for the mutual fund industry in Canada. In short, the CSA requested the industry to work together with a view to developing a 'self-regulatory organization' for the mutual fund industry and implementing other solutions proposed by the CSA. To this end discussions took place at the end of 1997 between representatives of the CSA, The Investment Dealers Association of Canada ("IDA") and the Investment Funds Institute of Canada ("IFIC"). The result of these discussions was an agreement between the CSA, the IDA and IFIC for the joint sponsorship and development of the Mutual Fund Dealers Association of Canada/Association canadienne des courtiers de fonds mutuels (the "MFDA") as a self-regulatory organization ("SRO") for mutual fund dealers in the provinces and territories of Canada. The MFDA has now been established with the object of representing mutual fund dealers as its members. The MFDA will regulate the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest. The MFDA will commence operations and begin regulating its members when it receives formal recognition as an SRO by members of the CSA.

DESCRIPTION OF THE MFDA

This document, entitled 'Description of the Structure and Self-Regulating Activities of the MFDA' (the "Description") is an outline and description of the MFDA and its intended role as an SRO for mutual fund dealers in Canada. The Description is a guide for understanding the structure and the proposed regulations of the MFDA and the basis on which the MFDA may be recognized as an SRO under applicable legislation.

Part II of the Description describes the background and the proposed organizational structure and operations of the MFDA.

Part III of the Description summarizes the draft Rules of the MFDA that will apply to members.

Part IV of the Description highlights certain operational issues that must be addressed prior to the MFDA becoming recognized as an SRO.

Part V of the Description sets out a summary of the recognition application process.

Appendix A of the Description sets out a glossary of defined terms used herein.

Appendix B of the Description sets out the MFDA's understanding of the proposed recognition criteria of the Alberta, British Columbia and Ontario Securities Commissions, (the "Recognizing CSA Members") along with the MFDA's response or commentary thereto.

Appendix C of the Description sets out a summary of the proposed MFDA fee model.

Appendix D of the Description sets out a summary of the development of the proposed MFDA fee model.

HISTORY OF DEVELOPMENT OF DRAFT MFDA RULES AND BY-LAWS

One of the first initiatives of the MFDA Board was to establish five industry committees (the "Industry Committees") to deal with the five key areas of regulation that would affect the business operations of members of the MFDA. These areas consisted of sales practices and compliance; books, records and administration; distribution structures; proficiency and continuing education; and capital, investor protection fund and insurance. The Industry Committees were formed in 1998 and were comprised of representatives of members of the IDA and IFIC, MFDA public directors and staff of the IDA, the CSA, IFIC and the MFDA. The intention was to encourage first hand industry representation and input together with the experience of regulatory staff. The Industry Committees completed their work and reported to the Board in May 1999.

In June 1999, the Board authorized and directed MFDA staff and Borden Ladner Gervais LLP to commence developing the MFDA's Rules, based on current statutory requirements, the recommendations of the Industry Committees, current industry practices, the standards of similar self-regulatory organizations and the announced requirements of provincial securities regulators. In this regard, a draft set of Rules were developed and presented to the Board in November 1999.

Draft By-laws were prepared by MFDA staff and Borden Ladner Gervais LLP at the same time as the draft Rules, and set out the general organizational and corporate governance structure of the MFDA. The draft By-laws contain all of the provisions of the By-laws currently in force and effect as well as additional provisions relating to the conduct of affairs of the MFDA, such as (i) the process for acceptance of members; (ii) annual and other fees; (iii) regional councils; (iv) the MFDA's investigation powers; and (v) the MFDA's disciplinary powers and hearing process.

In November 1999, the MFDA Board approved the application by the MFDA to the Recognizing CSA Members for recognition as an SRO on the basis of this Description together with the draft Rules and draft By-laws. On December 22, 1999, this Description and the draft By-laws and draft Rules were submitted to the Recognizing CSA Members in support of the MFDA's application for SRO recognition. In March 2000, the MFDA responded to the initial comments of the Recognizing CSA Members pertaining to the draft Rules and draft By-laws and provided clarification in connection therewith. On May 8, 2000 the Recognizing CSA Members provided additional comments on the draft By-laws and draft Rules to which the MFDA has also responded and provided additional clarification.

CSA Recognition Criteria

The Recognizing CSA Members have developed proposed criteria ("Proposed Criteria") for the recognition of the MFDA as an SRO. The Proposed Criteria have been provided to

the MFDA in draft form and are to be published for comment simultaneously with the publication of the application by the MFDA as an SRO and its draft By-laws, Rules and other materials. The Proposed Criteria and the basis on which the MFDA considers that it satisfies them are set out in Appendix B.

Part II - The MFDA as an Organization

1 BACKGROUND

1.1 Current Regulation of Mutual Fund Dealers

1.1.1 Registration

Current regulation of mutual fund dealers in Canada is primarily by registration of such dealers under applicable provincial and territorial legislation. In most provinces and territories, the securities legislation (hereinafter referred to as "provincial securities legislation") requires registration of persons and companies who are distributing mutual funds. The categories available for registration may apply to persons and companies who only distribute mutual funds, or may include other categories such as securities dealers and brokers who either distribute a wider range of financial products or are members of SROs. In addition, mutual funds may be distributed by persons or companies who are also registered in other financial sectors including insurance brokers and agents.

The result of this regulatory approach to the distribution of mutual funds in Canada is that there is a wide diversity of standards, rules and regulations applicable to mutual fund dealers depending on the nature of the entity and the jurisdictions in which they carry on business. This lack of consistency contributes to additional costs and inefficiencies in the financial market intermediation process in Canada relating to the distribution of mutual funds. In addition, a lack of resources and consistency has resulted in ineffective regulation in many aspects of the mutual fund distribution business.

1.1.2 Industry Studies

The explosive growth and popularity of mutual funds in the late 1980's and in the 1990's raised concerns among members of the mutual fund industry itself, regulators and consumers that the current regulatory structures for the mutual fund distribution business were inadequate in Canada. These concerns prompted the report by Ontario Securities Commissioner, Glorianne Stromberg, entitled "Regulatory Strategies for the Mid-90s: Recommendations for Regulating Investment Funds in Canada", January 1995 (the "Stromberg Report"). The CSA responded to the Stromberg Report and asked a group of industry leaders and representatives of regulators to comment on and make recommendations in respect of the Stromberg Report. This group, the Investment Funds Steering Group, submitted a report to the CSA dated November 1996 entitled, "The Stromberg Report: An Industry Perspective".

The Stromberg Report addressed what it called "The Perception of the Securities Regulatory System" in Canada and identified a number of deficiencies in the regulatory structure for the mutual fund industry, including: multiplicity of jurisdictions and regulators; lack of co-ordination; lack of trained regulatory personnel; lack of technical resources; high cost of compliance; slow filing times; and slow policy initiatives. The Stromberg Report then stated that: "These factors are justifiably of grave concern to the investment fund industry and it is my recommendation that priority be given to addressing these concerns. Accordingly, my first recommendations relate to measures designed to address the concerns about the regulatory structure". However, the recommendations of the Stromberg Report for a new regulatory structure were based on a more centralized national regime of federal and provincial government regulation than is possible at present, as well as the prospect that most if not all financial products (i.e. equity and debt securities, mutual funds, segregated funds, etc.) would be included in the same regulatory structure.

The CSA established priorities to accomplish the various recommendations made, including those relating to the regulation of mutual fund dealers. One of the high priorities of the CSA was the establishment of a national self-regulatory organization to regulate mutual fund dealers and, potentially, all dealers and distributors of financial products that are securities. It was recognized, however, that the Province of Quebec was taking a different approach to the regulation of certain market intermediaries including persons distributing mutual funds. It was also acknowledged that there are differences between the businesses and regulatory risks associated with market intermediaries (securities dealers, for instance) that distribute and deal in a wide range of financial products and services (including underwriting and investing client capital), and those associated with persons and companies who restrict their businesses largely to the distribution of mutual funds. As a result of its deliberations, the CSA encouraged the industry to develop a self-regulatory structure that would address the concerns identified and the solutions advocated by it. However, the CSA recognized that separate self-regulatory structures would likely be required for mutual fund dealers and for securities dealers, who handle a wide range of financial products. The Recognizing CSA Members are proposing amendments to their registration rules which will have the effect of requiring all mutual fund dealers to become members of a recognized SRO. This requirement is paralleled by a similar change requiring full service securities dealers to also become members of a recognized SRO.

1.2 National Self-Regulatory Organization

1.2.1 Self-Regulation

Self-regulation generally refers to members of a particular industry imposing on themselves and enforcing regulatory standards for the conduct of their business, as opposed to the establishment and enforcement of rules and standards by others (usually a government or regulatory authority). Self-regulation is also distinct from industry organizations that may promote common industry development objectives or set standards or codes of conduct for which there are no enforcement powers. A current hybrid approach is termed "self-management" which refers to the development and imposition of rules and standards by a third party, such as a government, with the enforcement and implementation left to the particular industry participants. Pure self-regulation in the mutual fund distribution business would have no intervention or other role by governments, securities commissions or other parties other than by the mutual fund distributors themselves. As is discussed elsewhere in this document (see section 4.6 of Part II), the proposal for the MFDA contemplates a significant role by government regulators (principally the CSA) by virtue of their role in: the recognition process for the MFDA as an SRO; approval of the By-laws, Rules and standards of the MFDA; oversight of the activities of the MFDA; and a right of recourse to the CSA by MFDA members with respect to the manner in which the MFDA exercises its powers. This model of self-regulation as contemplated by the proposal for the MFDA is similar to other SROs such as the IDA, The Toronto Stock Exchange, the Montreal and Canadian Venture Exchanges, and the National Association of Securities Dealers, Inc. ("NASD") in the United States.

There are many reasons for adopting self-regulation and the following benefits are often identified:

- Utilization of industry personnel who are close to the markets and bring expertise in the regulatory process.
- Accountability among members of the industry to set and maintain appropriate standards.
- The ability to recognize quickly circumstances requiring regulatory intervention and to respond to such developments by establishing necessary rules.
- The tendency for industries to set standards which are higher than government standards in protecting their common interest.
- Flexibility in the regulatory model which accommodates different businesses and regional interests as well as permitting co-ordination and consultation with government regulators.

Self-regulation, with appropriate regulatory oversight, has generally been endorsed by the securities and mutual fund industry in Canada as being the most effective way to both regulate the industry and protect the public interest. In this regard, the MFDA, as an SRO, has been organized for the purpose of regulating the operations and standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest.

1.2.2 National SRO

The prospect of a common regulatory structure for mutual fund distribution across Canada was discussed in the Stromberg Report and the other reports and initiatives that followed, as referred to above. Securities regulators in Ontario, Alberta and British Columbia have endorsed the concept of a national SRO. Securities regulators in several of the other provinces and/or territories have also endorsed the concept. The basis for recognizing the MFDA is different, however, in each jurisdiction. The legislation of some jurisdictions, British Columbia, Alberta, Ontario, Nova Scotia and Saskatchewan for instance, contemplates statutory recognition of SROs. Other jurisdictions may not have specific statutory recognition provisions in their legislation but the regulators appear to be willing to support the self-regulatory activities of the MFDA in lieu of their own regulation, subject to maintaining oversight and their overriding rule making authority.

Although the general vision is that the MFDA will operate as a national SRO with expected uniformity and consistency across the country (with the exception of Quebec), it is recognized that some different regional interests will be accommodated. Some of these differences may arise from the manner in which the distribution of mutual funds takes place in different regions in Canada and some may arise from legislative differences in the various provinces and territories. While it is hoped that these differences can be minimized, the structure of the MFDA is intended to accommodate such differences. Establishing MFDA regional offices and regional councils is for this purpose (see section 4.4 below).

1.3 **IDA and IFIC**

1.3.1 Investment Dealers Association of Canada ("IDA")

The IDA is an unincorporated association of its members which is comprised of investment dealers or brokers located in all the provinces and territories in Canada. The IDA was founded in 1916 and is currently the senior self-regulatory authority for the securities industry in Canada. Members of the IDA account for a very high percentage by volume and value of securities dealing in Canada. Its members conduct most of the underwriting of publicly distributed securities in Canada. The Toronto Stock Exchange no longer undertakes member regulation (as opposed to regulation of its own trading market) and its role in this regard was assumed by the IDA in 1997.

The IDA is a sponsor of the Canadian Investor Protection Fund ("CIPF") which is the compensation fund for customers of insolvent members of its sponsors. The other sponsoring institutions of CIPF are The Toronto Stock Exchange, and the Montreal and Canadian Venture Exchanges. CIPF

establishes standards (known as the "minimum standards") which are the basic standards with respect to capital, insurance, record keeping, internal controls, etc. for CIPF members.

In addition, the IDA endorses the Canadian Securities Institute ("CSI") which was founded in 1970 as the official Canadian securities industry educator to offer investment education to industry professionals and the public. The CSI offers courses nationally in both official languages. The CSI supports the Investor Learning Centre of Canada which promotes education for the investing public.

The IDA has a large, sophisticated and efficient staff dedicated to policy development and member regulation who are located in offices in Montreal, Toronto, Calgary and Vancouver. IDA staff visit and monitor compliance by its members in offices wherever they are located in Canada.

1.3.2 Investment Funds Institute of Canada ("IFIC")

IFIC is a non-profit trade association comprised of fund managers, retail distributors and representatives of professional associations such as legal and accounting firms. IFIC was founded in 1962 and is presently the only trade association representing all segments of the mutual fund industry. IFIC members represent approximately 95% of all mutual fund assets under administration.

In addition to its role as a developer of recommended mutual fund industry standards and lobbyist on federal, provincial and international policies, it is an educator of both the mutual fund industry, as well as the investing public through courses and public information materials.

1.4 **Agreement for the MFDA**

As discussed above under section 1.1.2 entitled Industry Studies, the CSA wished to encourage the industry to develop a self-regulatory structure that would address the concerns identified and the solutions proposed by the CSA for the mutual fund distribution industry in Canada. To this end, discussions took place throughout the latter part of 1997 between representatives of the CSA, the IDA and IFIC. The result of these discussions was an agreement between the IDA and IFIC for the joint sponsorship and development of the MFDA. The terms of the agreement were to be included in the constating documents and agreements to be entered into in respect of the MFDA. The essence of the agreement is that both the IDA and IFIC would have equal representation on the Board of the MFDA, together with an equal number of directors representing the public. The IDA, as an experienced self-regulatory organization operating throughout Canada, would be represented by its President and Chief Executive Officer who would also be the President and Chief Executive Officer of the MFDA. In addition to this executive responsibility for the administration of the MFDA, the IDA agreed to make available (on a cost recovery basis) its staff experienced in self-regulation to assist the directors, officers and staff of the MFDA. IFIC, as an experienced trade association for the mutual fund industry, would be represented by its Chair who would also be Chair of the MFDA.

Details of this agreement are described below in section 2.

2 LEGAL STRUCTURE

2.1 **The MFDA's Incorporation and Purpose**

The MFDA was incorporated as a non-share capital corporation under Part II of the *Canada Corporations Act* ("CCA") on June 19, 1998. The primary constating document ` `of the MFDA are its letters patent which provide for its name, initial incorporators and directors, objects and powers. As a corporation without share capital, the MFDA must carry on its objects and activities without pecuniary gain to its members and upon winding-up, its assets may not be distributed to its members. The MFDA is a distinct and separate legal entity. Unlike a business corporation, the MFDA has members as opposed to shareholders. These members do not have any personal liability with respect to the obligations of the MFDA.

The objects of the MFDA are set out in detail in its letters patent. The primary objects are summarized as follows:

- to encourage through self-regulation a high standard of conduct among members with regard to mutual fund distribution in Canada;
- to adopt, and enforce compliance with, such practices and requirements as may be necessary and desirable to maintain such standard in the interests of members, their clients and the public;
- to regulate members of the MFDA and persons who are or were shareholders, partners, directors, officers or employees of such members;
- to establish requirements for membership in the MFDA and the approval of individuals in respect of such members, and to monitor and enforce the same;
- to investigate, mediate and arbitrate grievances pertaining to the public, members and approved persons;
- to establish and maintain a compensation or protection fund for clients of members; and
- to facilitate members conferring amongst themselves on matters of common concern, including consultation and co-operation with governments, regulators, etc.

2.2 **Board of Directors**

2.2.1 Composition

The composition of the Board of the MFDA reflects the agreement for the MFDA made between the IDA, IFIC and the CSA referred to in section 1.4 above. As such, the By-laws provide that at any time one-third of the directors shall be nominees of the IDA, one-third shall be nominees of IFIC (one of which IFIC nominees must be a director, officer or employee of a mutual fund distributor which is not a member of IFIC) and one-third shall be public directors (i.e. persons who are not directors, partners, officers or employees of a member, or their associates or affiliates). Nominees of each of the IDA and IFIC may be appointed and removed from time to time by each of those organizations as they wish and in accordance with procedures set out in the By-laws. The public directors are nominated by the Governance Committee and elected by the directors (including public directors) on a staggered basis for two year terms, with a maximum of three consecutive terms.

2.2.2 Committees

Under the By-laws, the Board may appoint committees of the Board provided that each committee shall have equal representation by nominees of the IDA, IFIC and the public directors.

The Board has appointed an Executive Committee comprised of two nominees of the IDA, two nominees of IFIC and two public directors. The Chair of the MFDA is also the chair of the Executive Committee. The Executive Committee may, during intervals between meetings of the Board, and subject to any restriction imposed by the Board, exercise all powers of the Board in respect of the management and direction of the business and affairs of the MFDA. The Executive Committee, pursuant to its Terms of Reference approved by the Board, does not have the authority to fill vacancies among the directors, approve financial statements, make, amend or repeal By-laws, appoint officers, approve budgets or exercise borrowing powers.

The Board has appointed a Governance Committee comprised of such Directors as the Board may from time to time determine provided there shall be equal representation by nominees of the IDA, IFIC and public directors. This Committee is responsible for ensuring that an appropriate governance system is in place for the Board's overall stewardship responsibility and the discharge of its obligations to the stakeholders of the MFDA. The Committee is also responsible for the nomination process regarding nominees of public directors to the Board and for assessing the overall performance of the Board.

The Board has appointed an Audit Committee comprised of two nominees of the IDA, two nominees of IFIC and two public directors. The Audit Committee is to approve, monitor, evaluate, advise or make recommendations, in accordance with its terms of reference, on matters affecting the external audit, and the financial reporting and accounting control policies and practices of the MFDA.

The Board has also appointed a Compensation Committee. The Compensation Committee is responsible for reviewing the compensation levels of senior management, evaluating the performance of senior management and considering related matters.

2.2.3 Responsibilities

As an SRO, the MFDA has been organized to represent its members and to regulate the operations, standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest. The primary duty of the directors is to manage the affairs of the MFDA in pursuing this objective. The CCA and the By-laws confer upon the directors the authority to "administer the affairs of [the MFDA] in all things..." This duty of the Board to manage the affairs of the MFDA refers to oversight of MFDA management in conducting its operations.

In exercising their power and authority, the directors have a duty to act honestly, in good faith and in the best interests of the MFDA and to exercise an appropriate degree of care, diligence and skill. The CCA and the By-laws require that the directors of the MFDA disclose any interest they may have in contracts with the MFDA and to refrain from voting in respect of their approval.

Included in the general duties and responsibilities of the directors of the MFDA are the following:

- Ensuring that the Board is properly organized to carry out its duties.
- Establishing and organizing appropriate committees.
- Taking responsibility for determining the policy of the MFDA, delegating specific management functions to executive officers and others and monitoring management.
- Appointing and removing officers.
- Determining the management compensation policy for the MFDA.
- Ensuring that the financial affairs of the MFDA are conducted prudently in accordance with appropriate controls and monitoring.
- Admitting members of the MFDA.
- Establishing appropriate regulations and rules, codes of conduct, etc. to govern the business of members.
- Ensuring that the By-laws and Rules of the MFDA are properly enforced.
- Liaising with relevant regulatory authorities.
- Maintaining or causing to be maintained an appropriate investor protection plan for the clients of members.
- Ensuring that the mandate of the MFDA and its responsibilities are properly communicated to members, the investing public, regulators and other stakeholders.

2.2.4 Remuneration

The By-laws provide that the directors, except for public directors, shall serve as directors without remuneration and shall not directly or indirectly receive any benefit or profit from occupying the position of director. Public directors are entitled to reasonable remuneration as determined by the Board from time to time. The Board has approved remuneration for public directors in the amount of $10,000 per year and $1,000 per meeting attended. All directors are entitled to be reimbursed for reasonable expenses incurred in the performance of their duties for the MFDA.

2.2.5 Insurance and Indemnity

The role and duties of directors of the MFDA carry with them some potential liabilities. Most potential liabilities can be minimized by appropriate care and diligence by directors in carrying out their responsibilities, but additional protection is available in appropriate circumstances by way of indemnification and insurance. Directors of the MFDA are entitled to indemnification by the MFDA in accordance with the CCA and the By-laws in appropriate circumstances. Generally, if directors satisfy the standard of conduct expected of them, they will be entitled to protection. In addition, the By-laws permit it to acquire directors' and officers' insurance. Accordingly, the MFDA has arranged directors' and officers' insurance for the directors and officers of the MFDA in terms and amounts that have been considered adequate and prudent in the circumstances.

2.3 **Members**

As an SRO of the kind described in section 1.2.1 above, the fundamental principle for the MFDA is that its members carrying on mutual fund distribution activities participate in establishing and enforcing the standards by which such activities will be carried on. In the case of the MFDA, members will exercise this authority by participating, through their representatives, on the Board, regional councils and committees established by the MFDA. In addition, members will ratify all By-laws and Rules passed by the Board.

Admission to membership will be determined by the directors in the manner described in section 5 below. The admission procedures will contemplate due process for eligible applicants.

The draft By-laws also contemplate the circumstances in which a member may resign or be expelled. Subject to resolution of any outstanding enforcement matters, members will not generally be permitted to resign unless and until the MFDA has ensured that the financial obligations of the member, particularly to its clients, have been satisfied.

2.4 **By-laws and Rules**

2.4.1 Initial By-laws

The letters patent of the MFDA provide that its initial By-laws are those filed with the application for letters patent until repealed, amended, altered or added to. The CCA contemplates that the initial By-laws, as amended from time to time, permit the Board to enact By-laws relating in any way to the MFDA and the conduct of its affairs. However, no By-law can be effective until approved by at least two-thirds of the votes cast at a meeting of the members called for the purpose of considering same. In addition, no repeal or amendment of the By-laws not included in the letters patent may be enforced or acted upon until approved by the Ministry of Industry (Canada).

2.4.2 Rules

The By-laws contemplate that the directors of the MFDA may make or prescribe Rules relating to the management and operation of the MFDA, the admission, suspension and expulsion of membership, rights and obligations of members, the business and operating standards of members and their personnel and such other matters that relate to the MFDA and its objects**.** Such Rules made by the Board and amendments thereof are effective from their date only until the next annual or special meeting of the members of the MFDA at which time they are confirmed by the affirmative vote of a majority of the votes cast.

2.5 **Industry Committees on Regulation**

One of the first initiatives of the Board in 1998 was the establishment of five industry committees (the "Industry Committees") to deal with the key areas of regulation that would affect the operation of the businesses of members of the MFDA. These five areas consisted of sales practices and compliance; books, records and administration; distribution structures; proficiency and continuing education; and capital, contingency fund and insurance. The Industry Committees were comprised of representatives of members of the IDA and IFIC, MFDA public directors and staff of the IDA, IFIC, the MFDA and the CSA. The intention was to encourage first hand industry representation and input together with the experience of regulatory staff. The Industry Committees presented their recommendations to the Board in May 1999. These recommendations form the foundation of the MFDA's draft Rules.

Two of the Industry Committees, namely the Distribution Structures Committee, and the Capital, Contingency Fund and Insurance Committee, had to deal with particularly controversial issues. Distribution Structures was given the mandate to develop business structures that meet the requirements of the CSA and comply with existing securities legislation, while at the same time, cause the least amount of disruption to the mutual fund industry. The Distribution Structures Committee began by identifying all of the various business structures currently in use and the regulatory issues associated with them. The Committee then engaged in extensive discussions and consultations amongst its own

members and also with various individuals in the securities regulatory community. The final recommendations of the Distribution Structures Committee are the result of these discussions and reflect the consensus that was reached by all of the members of this committee and with the securities regulators.

The Capital Committee was given the mandate of recommending a formula for calculating capital and establishing minimum capital requirements. Recommendations had to be developed that would not only meet the standards of other SRO's but also reflect the business realities of mutual fund dealers. The Capital Committee ultimately recommended a "risk adjusted capital" calculation similar to the one in use by the IDA. It also developed unique recommendations for minimum capital requirements, based upon the nature of the dealer's operations. The Capital Committee was of the view that the nature of a dealer's operations is the most appropriate method for determining risk, and therefore for determining the minimum level of capital that should be maintained by a particular dealer.

2.6 **Administration**

2.6.1 Officers

The By-laws provide that the directors of the MFDA shall appoint certain officers of the MFDA. The remuneration of all officers appointed by the Board is determined from time to time by the directors. Officers are subject to removal by resolution of the Board from time to time. The duties and responsibilities of the officers of the MFDA are determined in accordance with the By-laws and the terms of their appointment as summarized below.

Chair. The Chair of the Board is to be the Chair of IFIC unless the organization with which he or she is affiliated does not have as a core business the retail distribution of mutual funds, in which event the Chair shall be the Chair of the Retail Distributor Council of Governors of IFIC. No person shall serve as Chair of the Board for more than one term and the Chair shall preside at all meetings of the Board and the members.

Vice-Chair. A Vice-Chair of the Board may be appointed from time to time by the directors who may act when the Chair of the Board is unable to act including presiding at meetings of the Board and the members.

President and Chief Executive Officer. The President and Chief Executive Officer shall be the President of the IDA who shall have the responsibility for general supervision of the business of the MFDA and such other powers and duties as the Board may specify.

Chief Operating Officer. The Board may appoint from time to time a Chief Operating Officer ("COO") who shall generally report to the President and Chief Executive Officer of the MFDA. In addition, pursuant to the terms of the Support Agreement with the IDA (see section 2.7), in certain circumstances, the COO is required to report directly to the Board. The COO shall manage the staff of the MFDA and carry out the administrative functions that are required for the operations of the MFDA.

Other Officers. The Board may appoint one or more Vice-Presidents, a Secretary, a Controller and other officers as may be appropriate.

2.7 **IDA Support**

The agreement for the establishment of the MFDA between the IDA, IFIC and the CSA referred to in section 1.4 contemplated certain regulatory and administrative support being provided by the IDA in order to complete the initial organization of the MFDA and to assist in the conduct of its regulatory responsibilities. The MFDA and the IDA have entered into an agreement effective as of the date of incorporation of the MFDA in June 1998 (the "Support Agreement"). Pursuant to the Support Agreement, the IDA has agreed to provide the MFDA the following services for the term of the agreement:

- The services of its President to act as President and Chief Executive Officer of the MFDA;
- The services of such IDA staff as the COO of the MFDA and the President of the IDA may agree are necessary or appropriate (as further described below); and
- On an interim basis, office facilities to be rented from the IDA.

The Support Agreement contemplates that the IDA will assist the MFDA with the provision of regulatory services including policy development, financial compliance, sales compliance, enforcement, registration and new member approvals. The IDA may also provide administrative services to the MFDA in connection with human resources, accounting and administration, public relations and initial financing and organization. The IDA is entitled to receive fees in connection with the foregoing services as approved by either the MFDA Board or its Audit Committee. In addition, the IDA is entitled to be reimbursed for its reasonable out-of-pocket expenses. The term of the Support Agreement is for three years from the date that the first mutual fund distributor member is admitted to the MFDA. This agreement is subject to a right by either party to terminate on 12 months notice following the first anniversary of the initial membership date referred to above, subject to the approval of members of the CSA who have recognized the MFDA as an SRO. The IDA may also indicate that it intends to terminate the Support Agreement if certain elements of the agreement for the establishment of the MFDA (as described in section 1.4) are to be changed. Such changes may not be made by the MFDA without the consent of the appropriate members of the CSA. The MFDA and IDA have also agreed pursuant to the terms of the Support Agreement to indemnify each other for the

actions of the other and their respective directors, officers, employees and agents for liabilities, costs, expenses, etc. arising from the provision of services under the Support Agreement.

2.8 **Financing**

Recognizing that the MFDA has no revenue of its own to fund its start-up costs, and will not have such revenues until members are admitted and fees of members are paid, the Ontario, British Columbia and Alberta Securities Commissions agreed to guarantee borrowings by the MFDA. The MFDA has arranged for a line of credit of up to $12 million from a major Canadian chartered bank to fund its start-up costs. Advances under this credit facility are guaranteed on a several, *pro rata* (not joint) basis by the Ontario, British Columbia and Alberta Securities Commissions as to 61%, 21% and 18%, respectively.

The credit facility provided by the bank contains relatively standard commercial terms as to performance by the MFDA and events of default. Loans drawn under the credit facility bear interest at bank prime plus 0.50 per cent.

2.9 **Tax Status**

The MFDA, as a non-share capital corporation under Part II of the CCA, was established as a not-for-profit operation and will not be subject to taxation under the *Income Tax Act* (Canada) on revenues received by it. Subject to appropriate reserves, it is expected that the MFDA's revenues will be offset by its expenses and it will not have net income that is subject to income tax. In this respect it is similar to the IDA, IFIC and other SROs.

3 SCOPE OF REGULATION

3.1 **Jurisdiction**

3.1.1 Basis of Jurisdiction

The primary basis upon which the MFDA exercises regulatory authority or jurisdiction over its members and their personnel is the binding effect of the MFDA's Rules and By-laws. Further, certain specific powers may be delegated or assigned by the applicable securities commission. The fact that the MFDA is recognized pursuant to provincial securities legislation does not in itself constitute the legal basis of its jurisdiction. It should be noted, however, that the extent and manner in which the MFDA determines to regulate its members will ultimately be subject to the oversight authority of the provincial securities regulators.

3.1.2 Objects

The current objects of the MFDA and its letters patent refer to, among other things, encouraging "through self-regulation a high standard of conduct among members in the mutual fund distribution industry in Canada" and to regulating "members and persons who are or were shareholders, partners, directors, officers, or employees of members, in accordance with the by-laws and rules of the corporation or as may be authorized or permitted pursuant to securities legislation..." There is no provision in these objects limiting the MFDA's regulatory authority to mutual funds.

3.1.3 Self-Imposed

When mutual fund dealers become members of the MFDA, they are subject to the By-laws and Rules which may be enforced by the MFDA as a matter of corporate law, in the sense that members must comply with the by-laws and rules of the corporation. In addition, MFDA members and their salespersons, partners, directors and officers and certain other personnel ("Approved Persons") will become contractually bound to the MFDA under the contract which is constituted by the application and approval forms and processes. In that regard, members and Approved Persons agree to be bound by the By-laws and Rules, current and future, as well as to comply with such other laws and requirements as may be referred to therein, i.e. provincial securities laws. This agreement can be enforced at law and forms the primary basis of jurisdiction of the MFDA. The foregoing principle is fundamental to the self-regulatory process as described in section 1.2.1 above.

3.1.4 Content of MFDA By-laws, Rules and Policies

Even though mutual fund dealers may be required by the securities regulators in certain jurisdictions to become members of a recognized SRO, such as the MFDA or the IDA, as members of an SRO, the members ultimately have control over the content of the By-laws, Rules and Policies. It is recognized, however, that there are limits to this principle of self-regulation in the sense that the CSA may, by the terms of recognition discussed below, prescribe aspects of the scope and content of the MFDA's By-laws, Rules and Policies. Further, no By-law, Rule or Policy of the MFDA may contravene applicable securities laws. Subject to these requirements, the MFDA and its members ought to be able to determine the range of the activities that will be subject to regulation by the MFDA.

3.1.5 Recognition Criteria

The MFDA will be the subject of a recognition process by certain members of the CSA pursuant to which its role as an SRO will be confirmed. Within the context of provincial securities legislation (the *Ontario Securities Act* ("OSA") being representative in this regard), a self-regulatory organization is defined to mean "a person or company that represents registrants and is organized for the purpose of regulating the operations and standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest". The OSA further provides that the commission may

recognize an SRO and make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of an SRO, if "it is satisfied that to do so would be in the public interest". As set out in Appendix B hereof, as part of the recognition process, the relevant securities commissions will develop and publish for public comment Proposed Criteria which the MFDA By-laws and Rules and structure must meet before they will recognize the MFDA as an SRO.

3.1.6 Assignment and Delegation

Although, as indicated above, the primary jurisdiction of the MFDA will not derive from securities legislation, certain specific functions may be assigned or delegated to an SRO pursuant to such legislation. In Ontario for instance, section 21.5 of the OSA permits the Ontario Securities Commission ("OSC") to assign to a recognized SRO any of the powers and duties of the OSC relating to the registration of companies and persons trading in securities, subject to such terms and conditions as it may impose. If the MFDA were to act under any such delegated or assigned powers, its jurisdiction would be directly based in the legislation even though the legislative provisions may refer to or parallel the Rules of the MFDA itself.

3.2 The MFDA's Proposed Scope of Regulation

3.2.1 Practical Considerations

The scope of regulation proposed to be undertaken by the MFDA is governed by a number of factors.

First, the MFDA must act within the legally prescribed limits of its authority and jurisdiction as discussed in section 3.1 above.

Second, the extent and manner in which the MFDA regulates its members and their personnel will be determined in part by the resources available to the MFDA.

Third, there may be practical difficulties in attempting to divide the regulation of a diversified financial services organization according to product lines, especially if all activities are carried out in one legal entity. For example, a member may sell insurance products, mutual funds, exempt securities, GIC's and offer financial planning advice. From the point of view of the MFDA, it may be difficult to distinguish and effectively regulate different product and financial service activities carried on by the same member and its personnel. There is potential for overlap and confusion in respect of particular regulations. In addition, there may be overlap and inefficiencies among various regulators.

Fourth, some aspects of the business and operations of a mutual fund dealer are common to all of its activities. Primary examples are capital adequacy and other prudential rules. The financial risks associated with all products distributed and other financial services offered by a member must be taken into account by a regulator. That is, a regulator cannot restrict itself to dealing with mutual funds alone and ignore the operational risks associated with the other financial service activities of the member, such as the distribution of exempt securities.

Finally, it can be expected that the regulatory activities of the MFDA will develop and change over time in response to market conditions and regulatory developments.

3.2.2 General Activities

The MFDA will implement a regulatory regime that includes Rules which govern activities relating to the trading of securities as well as the conduct of members in other respects.

As mentioned above, "self regulatory organization" is defined in the OSA as an organization "organized for the purpose of regulating the operations and standards of practice and business conduct of its members with a view to promoting the protection of investors and the public interest". The "business conduct" aspect of the MFDA's regulatory regime will not be limited to conduct which relates strictly to the trading of mutual funds or other securities. Rather, it will be broader, and reflect the MFDA's overriding investor protection and public interest mandate and the fact that certain non-securities related activities of a member may affect its securities trading business.

3.2.3 Securities Related Activities

The MFDA will regulate all activities of its members and their personnel to the extent they relate to trading or advising in "securities" (as such term is defined in provincial securities legislation). The definition of "securities" includes conventional debt and equity instruments and so-called "exempt securities" such as limited partnerships, tax shelters and similar specialty investments. In this regard, it is noted that this definition of "securities" is broad and inclusive, in the sense that the definition is open-ended, with no finite list of what is or is not a security. The determination of what constitutes a "security" is made in accordance with the interpretation of the legislation by members of the CSA or the courts.

3.2.4 Financial Planning Activities (other than securities related activities)

(a) *Regulatory Approach*. The regulation of financial planning activities in Canada is evolving and is recognized by industry participants and financial services regulators to be a complex subject. With respect to the MFDA, the CSA has requested that financial planning services be included in the definition of "dealer business" in the MFDA's By-laws but that the term "financial planning services" not be defined. Accordingly, the MFDA's By-laws and Rules reflect that request. However, in administering its Rules, the MFDA and its members will have to have some practical

understanding of what constitutes such services. One of the reference points for MFDA members in determining when the MFDA's requirements (as set out below in paragraphs (b) and (c)) will apply, will therefore be the CSA's proposed Multilateral Instrument 33-107 (the "Instrument"). The proposed Instrument applies to securities registrants and imposes proficiency requirements on such registrants who, in effect, "hold themselves out" as providing financial planning services through the use of certain titles or the provision of written financial plans, as described in the Instrument.

(b) *MFDA Financial Planning Business Structure Requirements*. In its Position Paper on acceptable distribution structures, the CSA Distribution Structures Committee stated that its long-term goal was that all financial service activities, including financial planning, conducted by a dealer's salespersons be conducted through and appear on the books of the dealer or other appropriately registered or licensed and regulated entity. The MFDA's requirements with respect to permitted business structures for members and Approved Persons, as set out below, is consistent with the foregoing regulatory approach of the CSA.

Members and Approved Persons - Directly - A member and/or Approved Person who provides financial planning services directly (i.e. through the member and not in connection with any other entity or separate business) will be carrying on "dealer business" for the purposes of the MFDA. Therefore, they will be subject to MFDA Rule 1.1 relating to business structures as well as the MFDA Rules of general application referred to in paragraph (c) below. Rule 1.1 contemplates all revenue being for the account of and recorded by the member, the relationship being that of employee, agent or introducing dealer and restricts the use of trade names or styles.

Dually-Licensed Approved Persons - Approved Persons that are dually-licensed to sell mutual funds and other products such as insurance contracts may hold themselves out as providing financial planning services for clients through either (i) the member, or (ii) their insurance agency which is registered and regulated by the relevant provincial insurance regulator. If they choose to conduct all of their financial planning activities through a registered insurance agency, they will not be subject to the MFDA's requirements with respect to "dealer business". They will, however, be subject to the MFDA "dual occupation" rules that will apply to any kind of commercial activity carried on outside of the member. For a discussion of the general requirements that apply to such outside activities, please refer to section 3.2.6 below.

Mutual Funds/Securities Only Approved Persons - Approved Persons that are registered or licensed to sell only mutual funds or securities may hold themselves out to clients as providing financial planning services only through their member. Accordingly, the conduct of financial planning activities by these Approved Persons must be in accordance with the MFDA's business structures Rules (see draft Rule 1.1 referred to above) as well as the MFDA's Rules of general application, discussed in further detail below.

Personal Corporations - Approved Persons, either directly or through a personal corporation, may not hold themselves out as providing financial planning services independently of either the member or an insurance agency duly registered with the relevant provincial insurance regulatory authority. Financial planning may only be conducted through the member or other appropriately registered or licensed and regulated entity.

(c) *MFDA Rules of General Application*. Approved Persons who engage in financial planning activities through the member, must, in addition to the business structures requirements noted above, also comply with the MFDA's Rules of general application with respect to any kind of "dealer business". For example:

- Proficiency - draft Rule 1.2.1(e) provides that any Approved Person that engages in financial planning services must comply with the requirements of any applicable legislation. This will include compliance with the proficiency requirements set out in the proposed Instrument once it is finalized and comes into force.

- Standard of Conduct - draft Rule 2.1 provides that each member and Approved Person must deal honestly and fairly with its clients; observe high standards of ethics and conduct in transacting business; and may not engage in any business conduct or practice which is detrimental to the public interest.

- Confidential Information - draft Rule 2.1.3 requires that client information be kept confidential and may not be disclosed to any other person without the express written consent of the client. Each Member must maintain policies and procedures relating to the

protection of information held by it in respect of clients.

- Conflicts of Interest - draft Rule 2.1.4 provides that the Member must be aware of the possibility of conflicts of interest and in the event of a conflict, the member must ensure that it is disclosed in writing and addressed by the exercise of responsible business judgment influenced only by the best interests of the client.

- Referral Arrangements - draft Rule 2.4.2 sets out conditions on when referral arrangements (whereby a member is paid or pays a fee for the referral of a client to or from another person) may be entered into, including disclosure obligations.

- Complaints - draft Rule 2.11 provides that every member must maintain a log of client complaints and shall establish and maintain written policies and procedures for dealing with client complaints to ensure they are dealt with properly and fairly.

3.2.5 Segregated Funds

Segregated funds created and issued by insurance companies are similar in most respects to mutual funds but are not generally considered to be securities for the purposes of provincial securities legislation (except in British Columbia where segregated funds are specifically included as securities but generally exempt from registration and prospectus requirements). The distribution of segregated funds is, therefore, generally subject to the requirements of the provincial and territorial insurance legislation and, to the extent applicable, federal Canadian legislation relating to the insurance companies issuing the contracts.

Generally, in order to distribute segregated funds to investors, the sellers or agents must be licensed to sell insurance under provincial and territorial insurance legislation. In most such jurisdictions, it is possible for such an individual to be also licensed to sell securities under provincial and territorial securities legislation. Hence, the individual is licensed to sell both insurance and securities on the basis of a dual licensing regime.

The CSA and representatives of provincial insurance regulatory authorities are currently reviewing the basis on which the regulation of mutual funds and segregated funds can be harmonized. Until regulatory direction is obtained in that regard, the MFDA has been advised by the CSA that insurance regulators will be responsible for the distribution activities of the MFDA members relating to segregated funds. Accordingly, the MFDA will not regulate the activities of its members and their personnel as they relate to the sale of segregated funds.

The foregoing position, however, does not mean that the MFDA will not be concerned with the effect of segregated fund distribution activities by its members and their personnel. First, the MFDA will require that members and their personnel comply with all applicable insurance and other regulatory requirements. Second, the MFDA will adopt a regulatory approach similar to that which is applicable to IDA members distributing segregated funds. Members of the IDA are specifically permitted to have their personnel licensed to sell segregated funds. However, the IDA has imposed restrictions and procedures in connection with that activity. For instance, IDA members that employ dually licensed representatives are subject to compliance with certain IDA requirements such as IDA By-law 18.5 which provides, among other things, that the member must acknowledge in writing to the IDA its obligation to supervise the individual and that the member establish and maintain procedures to ensure continuous service to clients and to address conflicts of interest.

3.2.6 Other Activities

It is expected that the primary business of the members of the MFDA will be the distribution of mutual funds. Under provincial securities legislation, MFDA members are expected to be registered or licensed in appropriate categories of "dealer" which, in most cases, will be as a "mutual fund dealer". Under Section 98.7 of the Regulation to the OSA, for instance, a mutual fund dealer is defined as being "a person or company that is registered solely for the purpose of trading in the shares or units of mutual funds". This provision, and comparable provisions in other provincial securities legislation, are generally interpreted to mean that the registration relates solely to the registrant's activities in trading in mutual funds, but it does not preclude such a registrant from carrying on other commercial activities in addition to mutual fund distribution. Further, under Section 127 (1) of the Regulation to the OSA, no individual shall be granted registration unless the individual is employed "full-time as a salesperson". Similar provisions are contained in other provincial securities legislation. Provided that the dealer ensures that any outside activity engaged in by the salesperson does not result in any conflict of interest with the client, salespersons have also been permitted by securities regulators to carry on other commercial activities in addition to mutual fund distribution.

Hence, in addition to those activities described in sections 3.2.1 to 3.2.5, MFDA members may wish to carry on other commercial activities. Consistent with the proposed scope of regulation outlined above, the MFDA does not propose to prescribe specific regulations for such non-securities related activities (assuming they are permitted or otherwise not prohibited by the relevant provincial securities regulator). However, the MFDA will ensure that such

activities do not prejudice its primary object of regulation of mutual fund dealers. Members and Approved Persons must always avoid potential conflicts of interest and ensure that engaging in such other commercial activities does not impair their ability to properly service clients or fulfil the obligations of a member. Further, a member or an Approved Person must not engage in any activity which would be unbecoming a MFDA member or otherwise bring the securities industry into disrepute. In this regard, the draft Rules provide that members and Approved Persons "shall observe high standards of ethics and conduct in the transaction of their business" and shall "not engage in any business conduct or practice which is unbecoming or detrimental to the public interest". Further, the draft By-laws provide that an MFDA member and Approved Person can be subjected to discipline and penalties if the member or Approved Person has engaged in any business conduct or practice which is "unbecoming or not in the public interest ". Reference is also made to the "Dual Occupations" Rule described in Section 8.2.1(d) of Part III hereof.

3.2.7 Limits on Regulation

Although the foregoing scope of regulation is very broad, the MFDA may choose to limit its practical regulation of activities of its members that may otherwise be within its jurisdiction. For instance, the MFDA may decide that it is not necessary, or that it is not able, to regulate certain activities of its members. This decision may be effected by simply leaving the activity unregulated or by prescribing restrictions on the business of members that would preclude members from engaging in such activity.

4 REGULATORY STRUCTURE

4.1 General

The description of the regulatory structure of the MFDA in this section refers to how and by whom the MFDA's regulatory functions will be carried out. As discussed above under section 1.2, the MFDA is an SRO. Accordingly, its regulatory structure will be based on the participation of its members, both in determining what Rules will apply to them as well as actually effecting the development of the Rules. As such, the participation of members and their personnel must be representative and include all kinds and sizes of businesses and regions in Canada. Also, in recognition of the growing convergence of the financial markets in Canada, the MFDA and its members must co-ordinate their activities with other financial services industries and their regulators. Lastly, although the primary feature of the MFDA is that it is an SRO, there will be oversight by members of the CSA.

4.2 Board of Directors

The Board of the MFDA is charged with the primary duty of managing its affairs. Managing the affairs of the MFDA refers to oversight of the MFDA management and its constituent bodies (such as regional councils and committees) and establishing the By-laws, Rules and Policies of the MFDA. Under section 2.2.3 of this Description, a number of general duties and responsibilities of the Board are set out. In the context of regulatory structure, these duties may be divided into three basic categories.

First, the Board is responsible for ensuring that the MFDA is established and operates properly according to its objects. Accordingly, with a view to promoting the protection of investors and the public interest, this entails ensuring that appropriate resources (personnel, funds, etc.) are available to ensure that the MFDA is able to adequately regulate the standards of practice and business conduct of its members and Approved Persons.

Second, the Board will be responsible for enacting the Rules of the MFDA which will contain the requirements and standards for regulating MFDA members. Although the Board must ultimately make such Rules, they will be based on the input of others in the MFDA regulatory structure, including committees established by the Board, MFDA staff, members of the CSA and members of the MFDA.

Third, the Board will have some limited direct regulatory functions. These regulatory functions will include accepting and terminating members and acting as a review or appeal body from decisions made by others, principally by regional councils (see section 6.7).

4.3 Members

Members will be admitted to the MFDA in accordance with the procedures described in section 5 below and will have the general rights and obligations described in that section. The membership of the MFDA as a body has a restricted role in performing the regulatory functions. The primary role of the membership as a body is to confirm or reject By-laws and Rules that have been approved by the Board. Individual members of the MFDA will participate in the self-regulatory process through representation on the Board, regional councils and standing committees. Participating in these roles will ensure that, ultimately, the members of the MFDA are, in effect, regulating themselves.

4.4 Regional Councils

4.4.1 Regions

The MFDA will create regional councils of its members to be located in appropriate geographic regions of Canada. Eventually the regions represented by a council may be each province and territory. Initially however, there will be fewer regional councils with some regional councils representing more than one province or territory. The number of regional councils will depend ultimately on the number and size of the members that are located in any given area. There will, however, be flexibility to

re-define regions in any other way in the future. The members of a region will include members of the MFDA having their head or principal office in the region, members having one or more branch offices in the region and members licensed to do business in the region by the applicable securities regulatory authority.

4.4.2 Composition

The composition of a regional council will be from 4 to 20 members including a Chair and Vice-Chair as determined by the members of the region by annual vote. The regional councils may also have *ex officio* members to be determined including, for instance, the past Chair of a region, the Chair and President of the MFDA, the regional director of the MFDA for that region, and others.

The objects of the MFDA require that it act in the public interest. Accordingly, each regional council will appoint a roster of individuals resident in the region who will be "public" members of the council for the purpose of conducting disciplinary and enforcement hearings referred to below. Individuals will not be eligible to be elected or remain as a public member if they are or become a member of the MFDA or a partner, director, officer or employee of an MFDA member or an associate, affiliate or related company of such a member. Further, only individuals who are legally trained and who are, or have been, qualified as legal practitioners shall be eligible for selection as a public member of a regional council.

4.4.3 Duties

Regional councils will act as the authority for discipline and enforcement matters with respect to members located in their region and will be representative of the members in their region. In addition, issues that are relevant to such members' businesses may be discussed and considered at regional council meetings. Local business conditions or regulatory requirements may require local policies to be developed that the regional councils would recommend to MFDA staff and the Board.

4.4.4 Committees

Many matters that are relevant to the business of MFDA members in the regions may best be considered by regional councils through standing committees established by the MFDA in conjunction with the regional council. These standing committees will have the authority as determined by their appointment, subject to co-ordination with MFDA general policy and initiatives.

The Board may also establish from time to time general committees of representatives of members or other interested parties to review and report on various matters relevant to the MFDA and its members. It is recognized that expertise will be required for the various issues that can be expected to arise and that the qualifications of persons appointed in respect of such committees will reflect the relevant expertise. The initial committees of the MFDA, being the Industry Committees referred to in section 2.5, are examples.

4.5 **Staff**

The day-to-day regulatory activities conducted by the MFDA will be carried on by its staff. In addition, as described in section 2.7 hereof, the IDA will be available to support the operations of the MFDA with certain staff resources during the establishment of the MFDA.

4.6 **Canadian Securities Administrators**

The regulatory operations of the MFDA will be subject to general oversight by the provincial securities regulators in the applicable jurisdictions. Although these members of the CSA will not have any direct role in the operations of the MFDA in the same way as members of the MFDA, they will have an important indirect role.

First, the recognition process anticipates approval by the applicable CSA members of the establishment and organization of the MFDA in their respective provinces, including the approval of the MFDA By-laws, Rules, Forms and Policies.

Second, under applicable provincial securities legislation, a CSA member may have the statutory authority to make decisions with respect to the affairs of the MFDA. As an example, Section 21.1(4) of the OSA permits the OSC to "make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization" where it is satisfied to do so would be in the public interest.

Third, decisions, orders or rulings of an SRO such as the MFDA may be subject to appeal to a CSA member (For example, Section 21.7 of the OSA provides for this).

Fourth, CSA staff will consult and participate with MFDA staff and MFDA committees in developing regulatory policies and applying such policies in appropriate circumstances. As is the case with other SROs, a degree of co-ordination between the MFDA and CSA members will be required.

4.7 **Panel Auditors**

The IDA and the other SROs which sponsor CIPF rely on the knowledge, experience and integrity of the auditors of their members in preparing accurate financial statements and regulatory filings. In order to act as an auditor of such an SRO member, the firm or person must satisfy certain criteria in respect of experience and be approved by the SRO. The “panel auditors” are comprised of the auditors approved by the SRO.

The MFDA may in the future consider establishing panel auditors in a similar manner as the IDA and CIPF if there is a demonstrated need. Initially however, the MFDA will not adopt the panel auditor approach. Rather, it will require the audit engagement partner with respect to the audit of a member to have at least 5 years experience auditing mutual fund dealers, securities dealers or financial institutions.

4.8 **Investor Protection Fund**

The proposed MFDA investor protection fund will have input into policy development of the MFDA as well as certain oversight functions relating to MFDA members. Please see Section 7 hereof.

5 MEMBERSHIP

5.1 **Eligibility**

Individuals, firms or corporations who wish to become members of the MFDA will be required to meet certain basic eligibility criteria. Subject to other considerations, including those referred to under section 8 of Part III hereof entitled "Business Structures and Qualifications", persons will be eligible for membership if they satisfy the following conditions:

- The applicant is a resident of Canada or, in the case of a firm or corporation, it is formed or incorporated under Canadian provincial, territorial or federal laws, as the case may be;
- The applicant carries on or proposes to carry on business in Canada as a mutual fund dealer;
- The applicant and its Approved Persons are duly registered in each jurisdiction in Canada under applicable securities legislation and any other legislation where the nature of its business requires such registration and is in compliance with such legislation and the requirements of any regulatory authority having jurisdiction over it; and
- The applicant, its Approved Persons and any applicable holding companies, affiliates or related parties, agree to comply with the By-laws, Rules and Policies of the MFDA.

5.2 **Application**

Admittance to membership in the MFDA will be by process of application. The application procedures adopted for members at the beginning of the MFDA's operations may require some modification in view of the large number of applicants to be dealt with and the limited time and resources that may be available. However, the basic process will be that prospective members will apply to the MFDA and, following review by MFDA staff, the final decision will be made by a panel of the Board. For further discussion of the proposed application and membership review process, please refer to section 13 of Part IV hereof entitled "Application and Membership Review Process".

Members of the CSA may also prescribe requirements in respect of their own registration process which requirements are in addition to those under the MFDA's application process. Therefore, it may also be necessary to adapt the application process to reflect that members may contemporaneously be applying to other regulatory authorities.

5.3 **Forms**

The MFDA will develop and have available for applicants and personnel of applicants, appropriate forms and instructions with respect to the membership application process. In this regard the materials required will be similar to those used by the IDA (with appropriate amendments to reflect the different requirements).

5.4 **Due Process**

The application procedure for prospective members of the MFDA will ensure that the applications are considered fairly and that applicants will have recourse in the case of adverse decisions. Such fairness will be ensured by different means including, initially, the eligibility requirements as referred to above and the objective assessment of financial criteria and ability to comply with applicable securities laws and the MFDA Rules and By-laws. MFDA staff will make initial determinations on these matters upon receipt of the application and will make recommendations to a panel of the Board appointed to consider membership applications. Such directors will make their own determination on discretionary matters, such as integrity and the public interest. If they propose to refuse the application or impose terms and conditions that are adverse to the applicant, the applicant will be entitled to be heard before the panel before they make their decision. Ultimately, decisions of the MFDA may be subject to review by members of the CSA who have jurisdiction pursuant to applicable securities legislation. See section 6.6 for information as to the approval process for membership.

5.5 **Fees**

5.5.1 General

The operations of the MFDA will be financed generally by fees charged to members in respect of applications for approval and annual fees. The Board will have the authority to determine such fees.

Sufficient funds must be raised to sustain the day-to-day operations of the MFDA in addition to retiring the indebtedness incurred by the MFDA in establishing its operations and carrying on its activities.

Additional assessments or fees of MFDA members will be required in connection with the Investor Protection Plan to be established. Please see sections 7 and 16 for a discussion of the Plan.

5.5.2 Development of Fee Model

The creation of the MFDA began with the development of an operating model that would best suit the regulation of mutual fund dealers. With the assistance of the Board and MFDA staff, PricewaterhouseCoopers ("PwC") was retained to perform a study of various SRO models and other regulatory bodies both in Canada and internationally. The study recommended the MFDA perform the following functions: new member assessments, member examinations, communications, policy development, investigations/enforcement and public complaints/inquiries. The study focussed on the frequency and scope of the above activities that are necessary in performing an appropriate level of member regulation. The analysis in this study regarding the appropriate level of regulation produced the underlying assumptions used in the creation of the Financial Projection for the MFDA. The Financial Projection estimates an annual revenue requirement of approximately $12 million to cover the cost of the MFDA's operations.

With respect to the revenue component of the Financial Projection, a committee of the Board developed certain fee model principles which set out the objectives for the fee model. These principles were the criteria against which each potential fee model was evaluated. After developing the fee model principles, the Board retained PwC to develop a recommended fee model. The Board directed PwC to consult with and obtain input from potential members regarding their views as to how fees should be determined. This consultation process was achieved through a series of workshops held in May 1999 in the three initial recognizing jurisdictions of British Columbia, Ontario, and Alberta. Attached as Appendix D is a summary of the development of the proposed MFDA fee model.

On June 14, 1999 PwC presented a report to the Board outlining its recommended fee model as well as the workshop results. PwC concluded that a consensus on this topic was not possible due to the number and variety of constituencies within the potential MFDA membership and their divergent views. However, PwC advised that a majority of the potential members participating in the workshops felt that an 'assets under administration' ("AUA") approach was a reasonable and fair model for assessing membership fees and that such AUA amount was easily obtainable and verifiable. Based on its analysis, including the workshop results, PwC recommended a fee model based on AUA.

Prior to adopting the AUA approach, the Board requested PwC to conduct further consultation with potential members to gain input regarding two issues:

1. the definition of AUA for the purposes of calculating the MFDA fees for a member; and

2. the incorporation of the concept of "economies of scale" for establishing the MFDA Fee Rate.

A request for comment on these two issues was sent to potential members in August 1999. On October 1, 1999, PwC presented a report to the Board summarizing the comments received from potential members on the above issues. Again PwC found differing opinions from the various constituencies. As a compromise solution, PwC suggested including money market funds in the definition of AUA and incorporating an economies of scale concept into the fee model. The Board approved PwC's suggestion on November 12, 1999.

5.5.3 The Integrated National Wealth Management Model (the "INWM Model")

During the fee model consultation process, the Board became aware of another fee model being proposed by certain mutual fund companies and managers whereby MFDA operating revenues would be collected and remitted by the mutual fund companies directly to the MFDA. The INWM Model is complex and involves a number of different aspects other than MFDA funding, such as the creation of an SRO and investor protection fund for mutual fund companies. It would also potentially fund the MFDA investor protection plan discussed in section 7 hereof. The INWM Model is still in the development stage. While the Board has approved a fee model, it also believes there are positive aspects to the INWM Model and has therefore established a committee to monitor the development of the INWM Model for future consideration. As there are a number of aspects of the fee model that are consistent with the INWM Model, changes could be made to the MFDA fee model if and when the INWM Model, or parts thereof, come into existence.

5.6 **Ownership**

Ownership of MFDA members will not be restricted, subject to overriding suitability or public interest considerations. With respect to changes in ownership, the draft By-laws provide that no member shall permit an investor to own a significant equity interest (essentially 10% of outstanding securities) in the member without the prior approval of the MFDA.

5.7 **Holding Companies**

MFDA members may be owned by holding companies or other entities, in order to permit flexible corporate structures for diversified financial groups. The extent of diversification will be limited according to permitted distribution structures (see section 8) as well as general suitability and public interest considerations. The consequences of utilizing a holding company structure may be affected by the requirements of the MFDA under its Rules. This may include undertakings by a holding company to ensure compliance with applicable laws and the Rules, as well as financial support by way of cross-guarantees between related companies.

5.8 **Resignations**

A member of the MFDA may choose to resign its membership at any time. Depending on the jurisdictions in which the member carries on business and the nature of the member's business, the resignation may impact the activities of the member permitted under applicable legislation. However, a member will not be permitted to resign unless and until the MFDA is satisfied that the obligations of the member to its clients and creditors have been satisfied. Procedures will be adopted similar to those of the IDA which will require filing of appropriate financial information, confirmed by auditors where necessary, indicating that such financial obligations have been, or will be, satisfied. Any resignation may be subject to appropriate terms and conditions imposed by the MFDA or the Board.

5.9 **Reorganizations, Transfers, etc.**

The draft By-laws provide for the reorganization of the business and ownership of MFDA members, including the purchase and sale of a business or assets or a change in control, without requiring a resignation or a new application for membership, in appropriate circumstances. This flexibility will accommodate changes in the business of members. However, the draft By-laws will not permit such reorganizations, transfers, change of control, etc. unless compliance with applicable laws and the MFDA Rules are preserved and the revenue base of the MFDA is not artificially reduced.

6 JURISDICTION AND ENFORCEMENT

6.1 **General**

The jurisdiction of the MFDA over its members and their personnel is described in section 3.1 entitled "Jurisdiction". In order to fulfil its self-regulatory responsibilities, the MFDA will exercise its jurisdiction over members and their personnel in several contexts including initial application for membership and/or approval, monitoring of compliance with the Rules on an ongoing basis and, when necessary, investigating alleged non-compliance and taking enforcement action to require compliance or impose discipline.

6.2 **Members**

Each member will be required to maintain a compliance system in order to ensure that the member and its personnel are in compliance with applicable requirements. Ultimate responsibility for compliance with the Rules is with the board of directors and senior management of the member. The chief executive officer or the chief financial officer, however, may be designated under the Rules for certain duties including the certification of financial information. In addition, members are required to have designated personnel such as a compliance officer and branch managers, with specific proficiency designations, each of whom will be responsible for internal compliance by the member. In other words, the member is expected to regulate its own business and the Rules will impose requirements in that regard.

Members will be subject to the review, enforcement and disciplinary procedures referred to in section 6.6. MFDA staff will be primarily responsible for reviewing the financial integrity and general operations of members to ensure that they are in compliance with the Rules and By-laws. In addition, members will be responsible for supervising the conduct of their personnel.

6.3 **Approved Persons**

MFDA staff will also review the activities of Approved Persons of members (essentially registered partners, directors, officers, designated compliance officers, branch managers and salespersons) in order to ensure compliance with the Rules. Some Rules will apply specifically to Approved Persons. In addition, certain Approved Persons will be directly responsible (in accordance with their authority and designated role with a member) for compliance by the member with the Rules applicable to the member. In addition, all Approved Persons will be expected to conduct themselves in a manner that is consistent with the Rules applicable to MFDA members.

6.4 **Other Personnel**

The references to the personnel of members referred to above is primarily to individuals who are required to be registered and/or approved under provincial securities legislation and the Rules. However, not all personnel employed by an MFDA member will be required to be so registered or approved. Accordingly, they will not necessarily sign the contract comprised, in part, of the application form for approval which binds Approved Persons to the jurisdiction of the MFDA. Although the member will be generally responsible for the conduct of all its personnel (whether approved and/or registered), personnel who are not required to be approved or registered will not generally be subject to the MFDA's enforcement jurisdiction.

6.5 **Examinations and Investigations**

In order for the MFDA to carry out its self-regulatory responsibilities, it will have the authority pursuant to its By-laws to conduct examinations and investigations in respect of its members and their personnel. Examinations and investigations may arise in different circumstances. The majority of the activities of the MFDA in this regard will be routine, in that members will file certain information (primarily financial results) on a periodic basis which will be reviewed by MFDA staff and staff of the MFDA Investor Protection Fund. In addition, compliance examinations will be arranged on a periodic basis.

The MFDA and its staff may also initiate examinations or investigations in other circumstances. Customer complaints will be reviewed and dealt with in accordance with the disciplinary procedures, if

necessary, referred to in section 6.6. The MFDA may also act at the request of or in consultation with other self-regulatory organizations, members of the CSA, other regulators (including non-securities regulators such as superintendents of insurance) and law enforcement agencies both in Canada and elsewhere. In order to facilitate such requests and consultation, the MFDA may enter into agreements with such other authorities to co-ordinate investigations and avoid duplication of efforts. The MFDA will be permitted to share information with such organizations in appropriate circumstances.

Generally, the results of the MFDA's examinations and investigations will be kept in confidence and not disclosed to the public except where specific consents to do so have been obtained from the parties concerned or as compelled by law.

Please refer to section 14 in Part IV hereof, entitled "Multi-Provincial Regulation", for a discussion of jurisdictional issues and how this may affect the manner in which the MFDA regulates its members.

6.6 **Approvals and Discipline**

It is the experience of most SROs and securities regulatory authorities that enforcing compliance with the required regulations is best accomplished by regular reviews and voluntary compliance by the member or personnel involved. However, the MFDA may be required to enforce compliance or impose discipline in cases where voluntary compliance could not be achieved.

With respect to initial approvals for membership, MFDA staff will review applications and in most cases be able to either recommend approval or request the applicant to correct any deficiencies that may appear. In such cases the amended application, together with the recommendations of MFDA staff, will be forwarded to the panel of Board members appointed to consider membership applications for approval (see section 5.2). With respect to approval of individuals, initially, this function is expected to be performed by the applicable provincial securities regulator. The eventual role of the MFDA in this process is still to be determined.

In cases where voluntary and informal corrections or amendments to membership applications cannot be made, applications will be forwarded to the panel of Board members appointed to consider membership applications with an explanation as to any deficiencies identified by MFDA staff. If this Board panel agrees with the recommendation of staff and proposes to either reject the application or impose terms and conditions which may be adverse to the dealer or individual involved, the Board panel will give the dealer involved an opportunity to be heard before it makes its decision to reject the application or impose adverse terms and conditions.

With respect to compliance matters involving members or individuals who have already been approved, if a voluntary disposition cannot be achieved, MFDA staff may commence disciplinary proceedings before the applicable regional council. Before imposing any disciplinary sanction either by way of withdrawal of approval, or by the imposition of adverse terms and conditions, the applicable regional council will provide to the member or Approved Person an opportunity to be heard. Even then, once disciplinary proceedings by a regional council have been commenced, there will be an opportunity for the parties to agree to the disposition of the matter by way of a settlement agreement.

The grounds for refusing an application, or the imposition of disciplinary sanctions, will include (i) failing to comply with applicable federal or provincial laws or the Rules, or (ii) engaging in conduct which is not becoming a member or which is contrary to the public interest. The regional council will have the authority to issue reprimands, impose fines (of up to $1,000,000 per offence or 3 times the pecuniary benefit gained), suspend or terminate the rights and privileges of the member or individual, expel a member altogether, or impose terms and conditions as may be considered appropriate.

Hearings will be conducted in accordance with the common law rules of natural justice. Although the application of the statutory powers procedure legislation in the various provincial jurisdictions will vary according to the jurisdiction involved, the rules and procedures of the MFDA and its regional councils will generally reflect in all material respects those requirements whether or not the legislation is applicable. However, the MFDA and its regional councils will have no statutory authority to subpoena or compel attendance by any person. Nor will the MFDA or its staff, including the members of regional councils, have statutory immunity in performing their functions unless, possibly in some jurisdictions, they are exercising an assigned or delegated responsibility as an agent or representative of the applicable provincial securities regulatory authority.

The initiation of enforcement proceedings and any resulting disciplinary decisions will be published by the MFDA by way of bulletin to its members and by press release and general dissemination to the media. In addition, CSA members will be informed.

The MFDA and its regional councils will not be entitled to impose restitutionary orders or damages in favour of clients of members who have not complied with the MFDA standards. It is expected, however, that the MFDA will eventually establish an alternate dispute resolution mechanism similar to that established by the IDA. This will permit customers to have complaints against members determined by mediation and binding arbitration up to a specified dollar limit.

6.7 **Appeals**

Decisions of regional councils with respect to members may be appealed to a panel of the Board.

Decisions of regional councils with respect to Approved Persons and decisions of the Board with respect to members will be subject to hearing and review by applicable members of the CSA who have assumed jurisdiction in that regard. In addition, persons or companies directly affected by decisions of the MFDA may, in the appropriate circumstances, have recourse to the CSA or civil courts.

6.8 **CSA Oversight**

Members of the CSA are expected to monitor the enforcement proceedings of the MFDA by way of receipt of regular reports and, on request, disclosure of the facts, circumstances and disposition of particular cases. As indicated above, members of the CSA may also request the MFDA to conduct investigations or examinations of MFDA members.

In recognition of the MFDA's limited resources and jurisdiction (i.e. it does not have the power to compel the attendance of witnesses or disclosure of information from third parties) the CSA may be expected to assume responsibility for particular investigations and enforcement actions where the circumstances warrant. The MFDA and its staff will assist in and/or co-operate with such activities of the CSA.

7 INVESTOR PROTECTION PLAN

7.1 **General**

The Stromberg Report recommended, as discussed in section 1 of Part II hereof, establishing a national SRO such as the MFDA and a protection fund for clients of SRO members. The model referred to was a protection plan similar to the Canadian Investor Protection Fund ("CIPF") that protects clients of securities dealers who are members of the IDA, the Montreal Exchange, the Toronto Stock Exchange and the Canadian Venture Exchange (formerly the Alberta and Vancouver Stock Exchanges). The Stromberg Report referred to the fact that the Provinces of British Columbia, Ontario, Quebec and Nova Scotia had established protection plans (the "Provincial Plans") for customers of registrants in those provinces but that the coverage available was limited to amounts of $2,500 to $10,000 depending upon the province. It is proposed that a protection plan be established for MFDA members (referred to herein as the "Plan" or the "Investor Protection Plan") and implemented on the basis described in section 7.8.

The purpose of the Investor Protection Plan will be to provide protection to clients of MFDA members if client property held by such members is unavailable as a result of the financial failure or insolvency of the member. The Investor Protection Plan would not provide compensation for losses arising from other causes such as fraud, changing market values, default of the issuer of a security or unsuitable investment advice. Protection would be available generally for cash and securities held by the member for clients. Other products, such as segregated funds which may be subject to other regulation, would also be entitled to coverage on a selected basis provided that the member actually held the property. Segregated fund products, for instance, would only be covered to the extent that the client's position was held and carried by the member (i.e. "on book" or in nominee name) and the same would be true for mutual fund or investment fund products in the sense that the property must be held by the member.

Notwithstanding that the form of the proposed Investor Protection Plan is as described in this section 7, options for other forms of protection will continue to be assessed including the possible use of insurance and the development of a larger scale mutual fund industry protection plan which would include issuers of mutual funds, such as the Integrated National Wealth Management Model referred to in section 5.5.3.

7.2 **Structure**

The proposed structure for the Investor Protection Plan is a trust fund similar to that of CIPF and the provincial plans established in British Columbia, Ontario and Nova Scotia. This structure has been proven to provide appropriate flexibility and minimize any income tax consequences that may be adverse to MFDA members. Accordingly, as a trust, the Investor Protection Plan requires trustees who would function as a board of directors or governors of the Plan. This board would be separate from the Board of Directors of the MFDA, although the Plan's board would work closely with the MFDA and would likely be represented at MFDA Board meetings and in other operations of the MFDA. As trustees, the Investor Protection Plan directors will have fiduciary responsibilities to the beneficiaries of the Plan, namely the clients of MFDA members, as well as the MFDA itself and its members to the extent that they have an interest in the assets and operations of the Plan.

7.3 **Board/Governance**

It is proposed that the Investor Protection Plan board will consist of seven members, three of whom will be "public" governors, three of whom would be industry governors representing the MFDA members and the other governor would be the Chair of the Plan.

7.4 **Roles and Functions of the Investor Protection Plan**

7.4.1 Roles

The Stromberg Report, as noted above, and the subsequent initiative of members of the CSA with respect to the MFDA, have assumed that the Investor Protection Plan would be similar to CIPF in its role as a protection plan and a participant in the regulation of mutual fund dealers. At the same time, it is recognized that there are differences between CIPF and the self-regulatory organizations which it sponsors and their members as securities dealers,

and the MFDA and the mutual fund industry. For one thing, there will only be one SRO (the MFDA) involved in regulating the mutual fund dealers whose customers will benefit from the protection of the Plan. Also, as the nature of the businesses are different, prudential (i.e. capital and solvency) and regulatory matters may be simpler in the case of the MFDA. On the other hand, it is generally acknowledged that the role of CIPF has worked very well and it has the confidence of both the securities industry, the SROs and, most importantly, the CSA. Set out below is a description of the various roles that the Investor Protection Plan will fulfill.

(a) *Management and Administration.* The core function of the Investor Protection Plan would be to collect and hold assets that are to be available and paid to customers in accordance with the terms of coverage. The basis on which this process takes place includes management and governance by the trustees, the investment of assets, the administration of Plan assets and employees (if any), dealings with third parties including regulators and, in the event of an insolvency, participating in the administration of the member's business, reviewing claims, making payments and ensuring that the Plan's protection objects are achieved.

(b) *Regulatory Policy.* The Plan will play a policy development role similar to that of CIPF, which has played a significant role in reviewing and establishing regulatory policy with its SROs. This role has developed partly as a matter of ensuring uniformity among several SROs but also on the basis that CIPF staff has been knowledgeable with respect to both Canadian and international securities regulation. The intended policy development role of the Investor Protection Plan, as with CIPF, will serve this function and ensure that member businesses are carried on in a manner that reduces risk to an acceptable level.

(c) *Co-ordination with the MFDA.* Because the proposed structure for the Investor Protection Plan (similar to that of CIPF) does not contemplate the Plan regulating members directly, the Plan would have an interest in ensuring that the regulatory activities of the MFDA are carried out in a manner consistent with the expectations of the Plan and the CSA. This role is often referred to as an oversight role and it is formally part of CIPF's structure and is required by agreements between CIPF and the CSA. Although the term "oversight" is used, the role is not so much "checking up on" the SROs as working with them in dealing with particular problems, receiving information relating to member audits and development of common policies and standards. In practice, this has been beneficial to all regulators.

(d) *Member Reviews.* As indicated above, investor protection plans such as CIPF do not directly regulate the members of their SROs, but CIPF does have the mandate to conduct occasional reviews of member firms over a period of time. However, the role of CIPF in these reviews is somewhat different than the regulators and direct reviews conducted by the SRO with primary regulatory responsibility. Historically, such reviews have served the purpose of ensuring uniform and correct application of regulatory policies by the SROs as well as reviewing members' operations from a different and, sometimes, more independent or objective viewpoint. It is intended that the Investor Protection Plan would fulfill a similar role.

7.4.2 Functions

Based on the foregoing range of roles and expectations as to the manner in which the MFDA and the Plan will develop in its first few years, it is proposed that the Plan have the following specific functions (with reference to the same role descriptions above):

(a) *Management and Administration.* Manage and administer the Plan assets, operations and member insolvencies. This function is essential and unavoidable under the proposed Plan structure.

(b) *Regulatory Policy.* Participate in prudential policy development by the MFDA. This function is important to risk assessment by the Plan and its trustees but will also be of assistance to MFDA staff and members. The Plan would not unilaterally set prudential policy standards but agreement between the Plan and the MFDA would be expected.

(c) *Co-ordination with the MFDA.* Co-ordinate with the MFDA and other securities regulators in monitoring the prudential regulation by the MFDA of its members. Under this function, Plan staff would be permitted to review and consult with MFDA staff in the application of prudential regulation of members. The intention would be that Plan staff could observe and assess regulation of members in the market for the purpose of policy development and risk assessment. There would be no controls or sanctions over the MFDA (as is the case with CIPF) although the Plan would be able to express its views and make recommendations to the MFDA and/or the CSA with respect to regulation.

(d) *Member Reviews*. Plan staff would not be expected to review member activities on a periodic basis for compliance purposes. However, Plan staff would be permitted on a limited or "as needed" basis to review members' operations for the policy and risk

purposes described above and, in the event of prospective insolvencies, would have full access to members and their operations.

7.4.3 Staff

The functions recommended above for the Investor Protection Plan will require staff resources but it is noted that the amount of resources and the required expenditure may vary according to the function. The financial resources of the MFDA and the Plan are also expected to be limited in their early years. It is recommended that initially the Plan contract the services of CIPF for all functions with the intention that within two to three years at least one dedicated staff employee be hired by the Plan itself. The need for further staff can be assessed over time. Observations on these recommendations with respect to staff are set out below (again with reference to the same function descriptions above):

(a) *Management and Administration.* Aspects of this function relating to the Plan in the normal course do not require the degree of specialized expertise that the others listed may require, but the experience of CIPF in administration and investor protection plan governance may be useful at first. As budgets and needs develop, this function could be turned over to a full or part-time dedicated Plan staff member.

The critical aspect of the Plan's functions relate to the occurrence of a member insolvency. In that event, experienced staff who can respond quickly and decisively are necessary. The Plan could not expect to maintain its own staff in this regard, and reliance on retained professionals when the occasion arises is expensive and not always satisfactory (on the basis that there is also limited professional experience in Canada). Therefore, access to CIPF staff on such occasions is critical. It follows that, if CIPF staff may be expected in the near term to play a critical role in assisting the Plan with member insolvencies, there is a benefit to having CIPF staff participate in the Plan's activities on some basis so that it is familiar with MFDA Rules and industry operations if and when an insolvency occurs.

(b) *Regulatory Policy.* This function may require more or less staff resources as determined and is, therefore, controllable to a degree. Until the appropriate amount of resources can be determined (and this will change over time) it appears better to hire expertise as needed. There are not many persons available in Canada with suitable regulatory experience and the ability to contract for at least some expertise from CIPF appears desirable.

(c) *Member Reviews.* As proposed, member reviews would only be optional or on an "as needed" basis. Depending on the circumstance, the degree of expertise may vary, but if there is the prospect of a member insolvency, it is likely that the same kind of CIPF experience referred to in paragraph (a) above would be required.

7.5 **Public Documents - Brochures, Policies**

The Investor Protection Plan and its directors will develop policies defining the scope of coverage that is available to customers of insolvent MFDA members and the circumstances in which such customers are eligible to receive compensation. These policies will be available to the public.

In addition to published coverage policies, it is expected that the Plan will prepare and distribute through the MFDA members, on the Internet and through other channels, brochures for the general information and education of the public and customers of MFDA members.

In general terms, the content of the policies and brochures will be similar to that of CIPF and materials made available by other customer compensation plans such as CDIC and Canadian insurance compensation plans.

7.6 **CSA Agreement**

The CSA will likely require an oversight agreement to be entered into with the Investor Protection Plan to ensure that the Plan offers the kind of protection considered appropriate. The subjects that can be expected to be included in such an agreement are representation of the public on the board of the Plan, prior notice of changes in fundamental aspects of the Plan such as coverage and funding, notice of MFDA member insolvencies, provision of financial information with respect to the Plan and the requirement that the Plan and the MFDA prescribe appropriate operating standards for MFDA members.

7.7 **Funding**

The ability of the Plan to provide adequate protection to clients of members of the MFDA and to perform its other regulatory responsibilities will depend on the financial resources of the Plan and its ability to pay for eligible client losses. The funding of the Plan will be separate from the funding for the MFDA itself as described in section 5.5. It is expected that the Plan will accumulate assets that will be available for the payment of eligible client losses and the operating expenses of the Plan. However, it will take some time for a significant amount of Plan assets to be accumulated and the immediate basis of funding and coverage provided will have to be determined.

It is expected that the sources of Investor Protection Plan funding will include some or all of the following:

(a) regular, periodic assessments on members based on a formula or other determined basis;
(b) income earned on the Plan assets;

(c) borrowings or lines of credit as available; and
(d) special assessments of members to reimburse the Plan for eligible client losses paid, or which the Plan may be obliged to pay, which assessments may be limited during any period.

Other sources of funds may be available including insurance (either primary or excess) or pursuant to the Integrated National Wealth Management Model (the "INWM Model") referred to in section 5.5.3. In addition, consideration is being given to the transfer of the current contributions of members to the Provincial Plans referred to in section 7.1.

The overriding principle is that MFDA members collectively are to be responsible for the payment of client losses (within defined limits). Although the ability to assess members for the payment of future losses will be available, the Plan is expected to become largely pre-funded over time. Contributions made by members through assessments become the property of the Plan and members will no longer have any proprietary interest in the contributions (or accretions to them), as is the case at present under the Provincial Plans which are funded on a “deposit” basis.

The MFDA proposes to retain CIPF (which will initially administer the Plan) to assist in the development of financial projections for the Plan including operating expenses, a possible funding formula, coverage limits and other aspects of the Plan’s operations. In addition, Mr. Donald Leslie, FCA has been retained to assist in this process, particularly as it relates to a funding formula and the possible development of the INWM Model. Preliminary work on these matters was undertaken by the MFDA Capital and Contingency Committee in the spring of 1999 in determining the structure of the Plan as well as preliminary assessment and coverage levels. Since that time the MFDA proposed fee model has been developed, the INWM Model has been introduced and the desire has been expressed for the Plan to consider coverage limits equal to CIPF’s ($1 million per general and retirement plan account).

The basis of funding the Plan, coverage limits and commencement of coverage will be determined according to the financial resources of members, competitive considerations in the financial services industry, actuarial-type projections and the interests of the investing public. These considerations may result in a staged implementation of full Plan coverage over time according to the resources of members, loss experience, risks and the actual amount of the Plan assets.

7.8 **Implementation**

It is intended that the MFDA Investor Protection Plan will be established on or before the date the MFDA is first recognized as an SRO. It is anticipated that as of such date, it will have a board of directors or governors, administrative procedures in place which are necessary to operate the Plan, management by contract through CIPF (subject to the settlement of terms with CIPF) and information available to the public as to the existence of the Plan and the proposed initial coverage limits that will apply to eligible claimants. It is further anticipated that members will become subject to periodic and, if necessary, special assessments, and their customers will become eligible for coverage as determined by the governors of the Plan and approved by the CSA. However, in recognition of the limited assets that the Plan will have at that date, it is expected that the Plan governors will set the initial coverage available to eligible claimants at a modest level with the expectation that coverage will be increased as Plan assets accumulate and member contributions are made. The MFDA or the Plan will publish for comment the proposed funding formula for the Plan, coverage levels and related information. It is also possible that although the Plan is established and assessments are being made by members to the Plan, coverage may be delayed pending accretion of sufficient assets in the Plan.

PART III - REGULATION OF MEMBERS : SUMMARY OF MFDA RULES

8 BUSINESS STRUCTURES AND QUALIFICATIONS

MFDA draft Rule 1 sets out the permitted business structures and minimum proficiency standards as follows:

8.1 **Business Structures**

8.1.1 Members

The following are acceptable business structures or relationships between members and any person conducting dealer business on account of a member:

(i) employer and employee;
(ii) principal and agent; and
(iii) introducing dealer and carrying dealer.

8.1.2 Trade Names

Any business carried on by the member or by an Approved Person on behalf of the member must be in the name of the member or a business or trade or style name owned by the member or an affiliated corporation of the member. The member must notify the MFDA prior to the use of any business or trade or style name other than the member’s legal name.

No member or Approved Person may use any name that is used by any other member unless the relationship with the other member is that of an introducing or carrying dealer.

No member or Approved Person shall use any name that is likely to deceive or mislead the public.

A member or Approved Person using a business or trade or style name must set out both the business or

trade or style name and the member's legal name in all materials issued to the public.

No member may permit its name to be used by an Approved Person in connection with any business other than the dealer business of the member.

The MFDA may prohibit a member from using any business or trade or style name in a manner that is contrary to the above provisions with respect to names or if it is objectionable on any public interest grounds.

8.1.3 Service Arrangements

A member or an Approved Person may engage a non-member to provide administrative services provided a number of conditions are met, including the requirement that the services provided do not in themselves require registration under securities legislation, or are duties or responsibilities that the member or Approved Person must perform directly pursuant to the By-laws, Rules or applicable securities legislation.

8.1.4 Employees

A member may conduct its business through Approved Persons who are employees provided certain conditions are met including the requirement that the member is responsible for and shall supervise the conduct of the employee as a salesperson in respect of the member's business including compliance with the applicable securities legislation and MFDA requirements.

8.1.5 Agents

A member may conduct its business by Approved Persons retained or contracted by it as agents provided that:

- the agent is duly registered or licensed under applicable securities legislation;
- the member is responsible for and supervises the conduct of the agent in respect of the member's business, including compliance with securities legislation and MFDA requirements;
- the member is liable to third parties (including clients) for the acts and omissions of the agent;
- business conducted by the agent on behalf of the member is in the name of the member;
- the books and records maintained by the agent in respect of the member's business are the property of the member and must be, upon request, available for review by and delivery to the member and by the MFDA;
- the agent is in compliance with applicable securities legislation and the By-laws and Rules;
- the insurance policies required to be maintained by the member cover and relate to the conduct of the agent;
- the agent shall not conduct dealer business with or in respect of any person other than the member;
- the member and the agent must have entered into a written agreement reflecting the above conditions which must be provided promptly to the MFDA upon request;
- the member shall provide the MFDA with a certificate and, upon the request of the MFDA, a legal opinion, confirming that the agency agreement reflects the above provisions and that the agency relationship is effective and in compliance with such provisions; and
- compliance with the terms of the above referenced agreement with the agent shall be monitored and enforced directly by the member and the terms or basis which the agent carries on any business or activities, other than the member's business, shall not prevent or impair the ability of the member or the MFDA from monitoring and enforcing compliance with the terms of the above referenced agreement or the By-laws or Rules.

8.1.6 Introducing and Carrying Arrangement

(a) *Permitted Arrangement.* The accounts of one member (the "introducing" dealer) may be carried by another member (the "carrying" dealer) provided certain conditions are met, including:

- the introducing dealer qualifies as a Level 1 dealer and the carrying dealer qualifies as a Level 4 dealer;
- introducing dealers may not introduce accounts to more than one carrying dealer; and
- the members must enter into a written agreement in a form prescribed by the MFDA evidencing the arrangement, and the arrangement or any changes (including termination) must be approved by the MFDA.

(b) *Terms of Arrangement*. The agreement evidencing the introducing/carrying arrangement must satisfy a number of requirements as set out in the Rules, including the requirement that the introducing dealer must maintain the minimum capital of a Level 1 dealer and the carrying dealer must maintain the minimum capital of a Level 4 dealer.

(c) *Insurance.* The introducing and carrying dealers are each responsible for providing financial institution bond coverage for fidelity insurance. The carrying dealer must include all client accounts that are held in nominee name and were introduced to it by the introducing dealer in its financial institution bond coverage.

(d) *Disclosure and Acknowledgment on Account Opening.* The introducing dealer must advise each client in writing at the time the account is

opened about the introducing dealer's and the client's relationship with the carrying dealer and obtain a written acknowledgment of the client regarding such relationship.

(e) *Disclosure on Contracts, Statements and Correspondence.* The name and role of the carrying dealer must (and the name of the introducing dealer may, in lesser size) be shown on all contracts, statements, correspondence, client communications, and other documentation. The use of business or trade style names shall be in accordance with Rules 1.1.7(a) to (f), inclusive. The carrying dealer is responsible for sending account statements and confirmations for all clients introduced to it as required under the Rules.

(f) *Clients Introduced to the Carrying Dealer.* Each client introduced to the carrying dealer by the introducing dealer is considered a client of the carrying dealer for the purposes of complying with the Rules.

(g) *Responsibility for Compliance.* The introducing and carrying dealers are jointly and severally responsible for complying with the Rules.

***[Note**: Additional introducer/carrier arrangements may be developed and incorporated into the Rules if the MFDA becomes aware of other dealer relationships that would warrant the creation of a new model. As experienced by the IDA, it is anticipated that the MFDA's introducer/carrier arrangements will develop and change over time.]*

8.1.7 Notification of Changes in Registration.

Every member must notify the MFDA of the following changes to:

- address for service;
- partners, directors and officers;
- commencement and termination of Approved Persons;
- opening or closing a branch or sub-branch office;
- information previously filed with the MFDA, including charges laid under criminal laws or securities legislation; and
- bankruptcy or insolvency proceedings.

8.2 **Individual Qualifications**

8.2.1 Salespersons

(a) *Course Requirements.* All salespersons must have completed one of:

- the Canadian Securities Course (Canadian Securities Institute);
- the Canadian Investment Funds Course (Investment Funds Institute of Canada); or
- the Investment Funds in Canada Course (Institute of Canadian Bankers).

(b) *Registration.* Salespersons must be registered with the applicable securities commission and agree in writing to be bound by the Rules and By-laws of the MFDA.

(c) *Training and Supervision.* All newly-registered salespersons will have 90 days to complete a mandatory training program and will be subject to a 6-month supervision period in accordance with such terms and conditions as may be prescribed from time to time by the MFDA.

(d) *Dual Occupations.* A salesperson may have and continue in another gainful occupation if certain conditions are met, including:

- the relevant securities commission permits the salesperson to devote less than his or her full time to the business of the member;
- such gainful occupation is not prohibited by the relevant securities commission;
- the member on behalf of which the salesperson carries on business acknowledges in writing to the MFDA its responsibility for the supervision of the salesperson in respect of that business;
- the member maintains procedures to ensure continuous service to clients and to address potential conflicts of interest; and
- any such other gainful occupation does not bring the mutual fund industry into disrepute.

(e) *Financial Planning.* Salespersons that hold themselves out to the public as offering financial planning services must comply with the requirements of any applicable legislation or regulatory requirements in connection therewith.

(f) *Business Titles.* Salespersons may not hold themselves out to the public in any manner (including through the use of any business name or designation of qualifications or professional experience) that deceives or misleads a client or any other person, as to the proficiency or qualifications of the salesperson.

8.2.2 Branch Managers

(a) Proficiency Requirements. An individual may not be designated as a branch manager or a co-branch manager unless the individual has (i) been registered previously under the applicable securities legislation as a trading partner, director, officer or compliance officer of a mutual fund dealer or a securities dealer; or (ii) in addition to the basic salesperson courses listed above, successfully completed any one of:

- Branch Managers Course (Canadian Securities Institute);
- Mutual Fund Branch Managers Course (Investment Funds Institute of Canada); or
- Branch Compliance Officers Course (Institute of Canadian Bankers).

(b) Experience Requirements. Branch managers must have acted as a registered salesperson (or a registered partner, director, officer or compliance officer) for a minimum of 2 years, or have a minimum of 2 years of equivalent experience, and be registered as a branch manager under applicable securities legislation.

***[Note**: The MFDA is proposing to delay the effective date of the Rule requiring 2 years experience for branch managers in order to give members time to implement this requirement. See Section 17 of Part IV hereof.]*

8.2.3 Trading Partners, Officers and Directors and Compliance Officers

(a) Course Requirements. In addition to the basic courses listed in section 8.2.1 above, all trading partners, directors and officers must have completed any one of:

- the Partners', Directors' and Senior Officers' Qualifying Examination (Canadian Securities Institute); or
- the Mutual Fund Officers', Partners' and Directors' Course (Investment Funds Institute of Canada).

[***Note**: The MFDA is proposing a transition period for trading partners, officers and directors of introducing dealers. See Section 17 of Part IV hereof.]*

9 BUSINESS CONDUCT

MFDA draft Rule 2 sets out minimum standards regarding business conduct and sales practices.

9.1 General

9.1.1 Standard of Conduct

Each member and Approved Person must deal honestly and fairly with its clients; observe high standards of ethics and conduct in transacting business; and may not engage in any business conduct or practice which is detrimental to the public interest.

9.1.2 Member Responsible

Each member is responsible for the acts and omissions of each of its Approved Persons relating to the member's business.

9.1.3 Confidential Information

Client information received by a member must be kept confidential and may not be disclosed to any other person without the prior written consent of the client. Each member must maintain policies and procedures relating to confidentiality and the protection of information held by it in respect of clients.

9.1.4 Conflicts of Interest

Members must ensure conflicts of interest are addressed by the exercise of responsible business judgement influenced only by the best interests of the client. Any conflicts of interest that arise must be immediately disclosed in writing by the member to the client prior to the member conducting business for the client. Members must also develop and maintain written procedures to encourage compliance with the Rules and identifying and resolving conflicts of interest.

9.2 New Client Accounts

9.2.1 Know-Your-Client

Each member must use due diligence to: learn the essential facts relative to every client and to every order or account accepted; ensure the acceptance of any order is within the bounds of good business practice; and ensure all recommendations made for any account are suitable for the client and in keeping with the client's investment objectives.

9.2.2 New Account Application Form

A new account application form must be completed for each new client account and the form must be signed by the client and dated.

9.2.3 New Account Approval

Each member shall designate a director, partner or officer, or in the case of a branch office, a branch manager who shall be responsible for the opening of new accounts and the supervision of account activity. The designated person must, prior to or promptly after the completion of any initial transaction, specifically approve the opening of such account in writing on the new account application form.

9.2.4 Changes to the New Account Application Form

The information contained in the new account application form for each client must be updated to include material changes in client information whenever a member or a salesperson becomes aware of such change or, at a minimum, annually. Written authorization must be obtained from the client for a change in a client name or address. The date upon which any such changes are made must be recorded in the books and records of the member.

9.2.5 Power of Attorney/Limited Trading Authorization

No member or salesperson may accept or act upon a power of attorney or other similar authorization from a client. A member may only accept a limited trading authorization from a client. A limited trading authorization, in a form prescribed by the MFDA, must be completed and approved by the designated compliance officer or branch manager, and retained in the client's file. Each trade made pursuant to a limited trading authorization must be designated as such for supervisory purposes. A limited trading authorization may not in any way confer discretionary trading authority upon the member or any person acting on behalf of the member.

9.2.6 Remuneration, Commissions and Fees

All remuneration in respect of a member's business conducted by a salesperson must be paid by the member directly to and in the name of the salesperson. No salesperson may permit any associate to accept remuneration or other consideration from any person other than the member in respect of activities carried out by such salesperson on behalf of the member.

9.2.7 Referral Arrangements

Referral Arrangements may only be entered into if:

(a) they are between members and other members or between a member and an entity that is (A) licensed or registered in another category pursuant to applicable securities legislation, (B) a Canadian Financial Institution, (C) insurance agents or brokers or (D) such other regulatory system as may be prescribed by the MFDA;
(b) there is a written agreement governing the arrangement;
(c) all fees or other compensation paid as part of the arrangement to or by the member are recorded on the books and records of the member; and
(d) written disclosure of the referral arrangement is made to clients prior to any transactions taking place. The disclosure document must include an explanation of how the referral fee is calculated such that the amount owing on account of such referral fee is determinable by such clients, the name of the parties receiving and paying the fee, and a statement that it is illegal for the party receiving the fee to trade or advise in respect of securities if it is not licensed or registered under applicable securities legislation to provide such advice.

9.2.8 Service fees or charges

No member shall impose on any client or deduct from the account of any client any service fee or charge relating to services provided by the member unless written notice has been given to the client on the opening of the account, or not less than sixty days prior to the imposition or revision of the fee or charge.

9.3 **Minimum Standards for Supervision**

9.3.1 Member Responsibilities

The Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of dealer business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation.

9.3.2 Compliance Officer

(a) Designation. Each Member must designate a trading officer as a "compliance officer" who shall be, or report to, any one of the Member's chief executive officer, chief operating officer or chief financial officer.

(b) Responsibilities. The compliance officer shall be responsible for monitoring adherence by the Member and any person conducting dealer business on account of the Member to the By-laws, Rules and Policies, including, without limitation, standards of business conduct under draft Rule 2 and adherence to applicable securities legislation requirements. The compliance officer or the individual to whom the compliance officer reports is required to report on the status of compliance at the Member to the board of directors or partners of the member as necessary, and at least on an annual basis. It shall be the responsibility of the board of directors or partners of the member to act on the annual compliance report and to rectify any compliance deficiencies noted in the report.

9.3.3 Branch Manager

(a) *Designation*. Each member shall designate a "branch manager" for each branch office of the member. If fewer than four salespersons carry on dealer business at a branch office of a member, the member is not required to designate an on-site branch manager provided that a branch manager that is not normally present at such branch office (or a trading, officer, partner, director or compliance officer) is designated and supervises the branch office in accordance with the Rules.

(b) *Responsibilities*. It is the responsibility of the branch manager to ensure that business conducted at the branch is in compliance with applicable securities legislation and the Rules and to supervise the opening of new accounts and trading activity at the branch office.

(c) *Alternates***.** In the absence of a branch manager or the inability of a branch manager to perform his or her responsibilities, a member must designate one or more assistant or co-branch managers who must be qualified as branch managers and who shall carry out the responsibilities of the branch manager.

9.3.4 Maintenance of Supervisory Review Documentation

The member must maintain records of all compliance and supervisory activities undertaken by it pursuant to the By-laws and Rules.

9.3.5 No Delegation

No member or director, officer, partner, compliance officer, branch manager, or assistant or co-branch manager of a member, shall be permitted to delegate any responsibility for supervision or compliance except as expressly permitted under the Rules.

9.3.6 Leveraged Securities Purchases

Each member must provide a disclosure document in the form prescribed by the MFDA (i) at the time of account opening; and (ii) where a salesperson makes a recommendation for purchasing mutual fund products or other securities by leveraging, or otherwise becomes aware of a client's intent to employ borrowed moneys for the purposes of investing, provided that a statement does not have to be provided under (ii) if the recommendation occurs within 6 months of the account opening.

9.3.7 Advertising and Sales Communications

No member may issue to the public, participate in or knowingly allow its name to be used in respect of any advertisement or sales communication which is untrue or misleading. In addition, no advertisement or sales communication may be issued unless first approved by a partner, director, officer or branch manager who has been designated by the member as being responsible for advertisements and sales communications.

9.3.8 Client Communications

(a) Definition. For the purposes of the By-law and Rules "client communication" means any written communication by a member to a client of the member including trade confirmations and account statements.

(b) General Restrictions. No client communication shall:

- be untrue or misleading or use an image such as photograph, sketch, logo or graph which conveys a misleading impression;
- make unwarranted or exaggerated conclusions or fail to identify the material assumptions made in arriving at these conclusions;
- be detrimental to the interests of the public, the MFDA or its members; or
- contravene any applicable legislation or any guideline, policy, rule or directive of any regulatory authority having jurisdiction over the member.

(b) Rates of Return. In addition to complying with the foregoing requirements, any client communication containing a rate of return regarding a specific account must explain in writing to the client the methodology used to calculate such rate of return.

9.3.9 Internal Controls

Members must establish and maintain adequate internal controls as prescribed in MFDA policies.

9.3.10 Policies and Procedures Manual

Members must establish and maintain written policies and procedures (that have been approved by senior management) for dealing with clients and ensuring compliance with MFDA Rules, By-laws and Policies and applicable securities legislation.

9.3.11 Complaints

Members must maintain a complaints file and establish written policies and procedures for dealing with client complaints in a prompt and fair manner.

9.3.12 Transfers of Accounts

In order to facilitate the transfer of the accounts of customers between members, the Rules provide for: procedures which contain time limits; required authorization from clients; notification between members; and notice to mutual fund companies. The Rules are intended to ensure prompt and safe account transfers. The member to which the client is transferring his or her account must treat the client as a new client (including the completion of a New Account Application form), but the client remains the responsibility of the member from which the account is being transferred until the transfer is complete.

10 FINANCIAL AND OPERATIONS REQUIREMENTS

MFDA draft Rule 3 sets out minimum standards with respect to capital and financial reporting requirements.

10.1 Capital

10.1.1 Minimum Capital

Members must maintain at all times risk-adjusted capital greater than zero and minimum capital in the amounts referred to below for the level in which the member is designated:

Level	Description
Level 1	$25,000 for a member which is an introducing dealer.

[Note: If additional introducer/carrier arrangements are developed, it is likely that each type of introducer would be subject to a different capital level.]

Level 2 $75,000 for a member which:
a) does not hold client cash, securities or other property; and
b) does not act as an agent of a trustee in administering the accounts of client self-directed plans which are registered for taxation purposes.

Level 3 $125,000 for a member which:
a) does not hold client securities or other properties except client cash in a trust account; and
b) does not act as an agent of a trustee in administering the accounts of client self-directed plans which are registered for taxation purposes.

Level 4 $200,000 for any other member, including a member which acts as a carrying dealer.

10.1.2 Notice

If at any time the risk adjusted capital is, to the knowledge of the member, less than zero the member must immediately notify the MFDA.

***[Note**: 1. Transition Period - The MFDA is proposing a transition period in order to provide members sufficient time to accumulate the above minimum capital levels. The following table sets out the MFDA's proposed transition periods and minimum capital levels:*

Member Level	*Minimum Capital Required at Time of Application to the MFDA*	*Minimum Capital Required at the End of the First Year the MFDA is recognized*	*Minimum Capital Required at the End of the Second Year the MFDA is recognized*	*Minimum Capital Required at the End of the Third Year the MFDA is recognized*
Level 1	*$15,000*	*$25,000*	*$25,000*	*$25,000*
Level 2	*$25,000*	*$45,000*	*$60,000*	*$75,000*
Level 3	*$25,000*	*$60,000*	*$95,000*	*$125,000*
Level 4	*$25,000*	*$85,000*	*$145,000*	*$200,000*

2. Commission Capital Requirement - Please note that members will also be expected by securities commissions to comply with the capital requirements under applicable securities law.]

10.2 **Capital and Margin**

10.2.1 Client Lending and Margin

No member shall lend or extend credit to a client or permit the purchase of securities by client on margin.

10.2.2 Calculation of Member Capital

Each member shall maintain capital in respect of its firm business calculated in accordance with requirements set out in the relevant MFDA Forms.

10.2.3 Advancing Mutual Fund Redemption Proceeds

Members may advance funds from the redemption of mutual fund securities only if:

(a) the member has received prior written confirmation of the redemption order from the issuer of the securities;
(b) the redemption proceeds to be received (excluding any fees or commissions) are equal to or greater than the amount of funds or credit to be provided;
(c) the client has authorized the issuer of the securities to pay the redemption proceeds to, or to the direction of, the member;
(d) the member maintains a copy of the confirmation of the redemption order and the client's authorization in its books and records; and
(e) the member is a Level 2, 3 or 4 dealer.

10.2.4 Related Company Guarantees

Each member is responsible for and must guarantee the obligations to clients incurred by each of its related companies, and each related company is responsible for and must guarantee the obligations of the member to its clients on the basis set out in the Rules.

10.3 **Segregation of Client Property**

10.3.1 General

Each member that holds cash and securities or other property of its clients shall hold such cash, securities or property apart from its own property, in trust, in accordance with the MFDA Rules and Policies.

10.3.2 Cash

(a) All cash held by a member on behalf of clients must be held in a designated trust account with a financial institution. Each member must determine on a daily basis the amount of cash it holds for clients that is required to be held in segregation.

(b) The Member must advise the financial institution holding the account, in writing, that:

(i) the account is established for the purpose of holding client funds in trust and the account should be labelled as a "trust account";

(ii) money is not to be withdrawn, including by way of electronic transfer, by any person other than authorized employees of the member; and

(iii) the money held in trust cannot be used to cover shortfalls in any other accounts of the member;

(c) The member shall not commingle money for mutual fund transactions with money held in trust for the purchase or sale of other securities or financial instruments (such as guaranteed investment certificates or segregated funds). The member must maintain separate accounts, which may be designated as trust accounts, for the purchase and sale of other securities or financial instruments.

(d) Trust accounts must be established to earn a market rate of interest.

(e) The member shall not use any money received for the investment of mutual funds or other securities to finance their own operations.

(f) The member must have a system in place to properly distribute on a cash basis interest earned on the mutual fund trust account to either the mutual fund companies or mutual fund investors.

10.3.3 Segregation

A member which holds securities or other investment products of clients in segregation may hold securities in bulk segregation but shall maintain sufficient books and records to specifically identify the client for which it holds the security. The member shall determine the market value and number of securities it holds for clients.

10.4 **Early Warning**

10.4.1 General

A member may be designated in early warning Level 1 or Level 2 according to its capital, profitability and liquidity position from time to time, or at the discretion of the MFDA, as provided in the Rules. As soon as practicable after the member is designated as being in an early warning level, the member must comply with the requirements for that early warning level set out in the Rules.

10.4.2 Restrictions

The MFDA may prohibit a member which is designated as being in early warning Level 2 from opening any branch offices, hiring any new persons, opening new client accounts or changing in any material respect its capital investments.

10.4.3 Duration

A member shall remain designated as being in early warning Level 1 or Level 2, as the case may be, until the latest filed monthly financial reports of the member demonstrate in the opinion of MFDA staff that the member is no longer required to be designated as being in an early warning category.

10.5 **Filing Requirements**

10.5.1 Monthly and Annual

Each member must:

(a) file monthly with the MFDA a copy of its unaudited financial report comprised of Statements A, B, C, D, Schedule 1 and the Certificate of Partners or Directors of Form 1 as at the end of each fiscal month *[**Note**: A transition period will be proposed allowing members to file quarterly for two years after the MFDA is recognized as an SRO];* and

(b) file annually with the MFDA its audited financial statements in a manner consistent with the MFDA's Form 1 as at the end of the member's fiscal year. These annual statements must be filed through the member's auditor within seven weeks of the date they are required to be prepared.

10.5.2 Related Companies

In addition to the statements referred to above, each member must file annually with the MFDA through the member's auditor, particulars of the name and relationship to the member of each related company and such financial statements and reports with respect to the affairs of each related company related to the member as the MFDA considers necessary.

10.6 **Audit Requirements**

10.6.1 Standards

The audit of a member must be conducted in accordance with generally accepted auditing standards and must include a review of the member's accounting system and the system of internal account controls and procedures for safeguarding assets. It must include all audit procedures necessary under the circumstances to support the audit opinion. The substantive audit procedures relating to the financial position must be carried out as of the audit date and not as of an earlier date, notwithstanding the audit is otherwise conducted in accordance with generally accepted auditing standards.

10.6.2 Scope

The scope of the audit must include the audit tests and/or other auditing procedures that are set out in the Rules.

11 INSURANCE

MFDA draft Rule 4 sets out minimum insurance requirements for members.

11.1 **Financial Institution Bond**

Every member must maintain a financial institution bond with the coverage specified in the Rules. The minimum amount of insurance to be maintained for each type of loss required to be covered must be the greater of (i) $500,000 or, in the case of a level 1 or level 2 dealer,$200,000, and (ii) one percent of the "base amount" as such term is defined in the Rules, up to a maximum of $25 million.

The "base amount" is the greater of:

(a) the aggregate net equity for each client determined as the total value of cash and securities owed to the client by the member less the total value of cash and securities owed by the client to the member; and

(b) the total allowable assets of the member determined in accordance with the financial questionnaire.

11.2 **Errors and Omissions Insurance**

Both the CSA and the MFDA Distribution Structures Committees recommended that a dealer *should* have adequate errors and omissions insurance to cover financial planning activities while the MFDA Capital and Contingency Committee recommended the dealer *must* have professional liability/errors and omissions insurance coverage. The IDA does not mandate errors and omissions coverage. Once the MFDA is fully operational (and has a complete profile of its members), it will investigate the cost and availability of such insurance as well as the implications of making such insurance coverage mandatory. In the event that it is concluded that such coverage should be mandatory, a Rule in this regard can be passed post recognition.

12 BOOKS, RECORDS AND REPORTING

MFDA draft Rule 5 sets out the minimum requirements for books and records.

12.1 **Requirements for Records**

Every member must keep such books, records and other documents as are necessary for the proper recording of its business transactions and financial affairs and the transactions that it executes on behalf of others and shall keep such other books, records and documents as may be otherwise required by the MFDA.

12.2 **Storage Medium**

All records required to be maintained by a member may be kept by means of mechanical, electrical, electronic or other devices provided:

(a) the method of record keeping is not prohibited under any applicable legislation;
(b) there are appropriate internal controls in place to guard against the risk of falsification of the information recorded;
(c) such method provides a means to furnish promptly to MFDA staff legible, accurate and complete copies of those records which are required to be preserved; and
(d) the member has suitable back-up and disaster recovery programs.

12.3 **Client Reporting**

12.3.1 Delivery of Account Statements

Each member must send an account statement to each client in accordance with the following minimum standards:

(a) once every twelve months for a client name account;

*[**Note**: The MFDA is proposing a transition period of one year after the MFDA is recognized as an SRO to provide members who operate in client name time to comply with the account statement requirement. The member would have one year in which to develop a system to deliver account statements to clients provided the member satisfies itself that the mutual fund companies are sending account statements to its clients.]*

(b) once a month for nominee name accounts (or for accounts for which the member is acting as agent of a self-directed registered retirement savings plan) where there is an entry during the month and a cash balance or security position; or

(c) quarterly for nominee name accounts (or for accounts for which the member is acting as agent of a self directed registered retirement savings plan) where no entry has occurred in the account and there is a cash balance or securities position at the end of the quarter.

12.3.2 Automatic Payment Plans

Where a member holds client assets in nominee name and the only entry in a month relates to an automatic payment plan that provides for systematic trading on a monthly or more frequent basis, the member must send an account statement at least quarterly.

12.3.3 Content of Account Statement

(a) *Nominee Name Accounts.* Account statements for nominee name accounts or accounts where the member acts as an agent for the trustee for the purpose of administering a self-directed RRSP must contain the following information:

- the opening balance;
- all debits and credits;
- the closing balance;
- the quantity and description of each security purchased, sold or transferred;
- the quantity, description and market value of each security position held for the account; and
- the date of the respective transactions.

(b) Client Name Accounts. Account statements for client name accounts must contain the following information:

- all debits and credits;
- the quantity and description of each security purchased, sold or transferred including the date of each transaction; and
- for automatic payment plan transactions the date the plan was initiated, a description of the security and the initial payment amount made under the plan.

(c) For all Accounts

(i) the type of account;
(ii) the account number;
(iii) the date the statement was issued;
(iv) the period covered by the statement;
(v) the name of the Approved Person(s) servicing the account; and
(vi) the name, address and telephone number of the member.

(d) Restriction. Only transactions executed by the member may appear on the account statement.

12.3.4 Consolidated Statements

The MFDA Rules require members to send account statements to clients that reflect only those transactions executed by the Member. However, it is current industry practice to send statements that provide additional information relating to other transactions that have not been executed by the member. Such statements are commonly called "consolidated statements". Since consolidated statements include transactions or positions that have not been executed or held by the member, these statements do not comply with draft Rule 5.3.3 and therefore do not constitute client "account statements" as envisioned in draft Rule 5.3. However, Members must ensure that such "consolidated statements" comply with the MFDA's Rules on Client Communications described in paragraph 9.3.8 herein.

12.4 **Trade Confirmations**

12.4.1 Delivery of Confirmations

Every member who has acted as principal or agent in connection with any trade must promptly send a written confirmation of the transaction to the client. The member does not have to send to a client a written confirmation of a trade in a mutual fund security where the manager of the mutual fund sends the confirmation containing the required information.

12.4.2 Automatic Payment Plans

For automatic payment plan transactions where the mutual funds are registered in nominee name the Member must send a trade confirmation for the initial purchase only.

12.4.3 Content of Confirmation

Every confirmation of trade sent to a client must include the following information:

- the quantity and description of security;
- the price per share or unit of which the trade was effected;
- the consideration;
- the name of the member;
- whether or not the member is acting as principal or agent;
- if acting as agent, the name of person or company from, to or through whom the security was bought or sold;
- the type of account through which the trade was effected;
- the commission, if any, charged for the trade;
- the amount deducted by way of sales, service and other charges;
- the amount, if any, of deferred sales charges;
- the name of the salesperson, if any, in the transaction;
- the date of the trade;
- the settlement date; and
- for automatic payment plan transactions, the date the plan was initiated and a description of the security and the initial payment made

under the plan.

12.5 **Record Retention**

Each member must retain copies of the records and documentation for such time as may be prescribed by the MFDA.

12.6 **Access to Books and Records**

Upon request, members must provide the MFDA with access to their books and records.

PART IV – OPERATIONAL ISSUES

The following is a summary of various issues that must be resolved prior to the MFDA becoming fully operational as an SRO.

13 APPLICATION AND MEMBERSHIP REVIEW PROCESS

13.1 **Proposed CSA Rule**

The MFDA understands that the OSC (and likely the ASC and BCSC) is considering publishing a revised version of the proposed rule regarding the requirement for mutual fund dealers to be members of an SRO. In this regard, MFDA staff have discussed with certain CSA staff a proposed rule which would provide that every mutual fund dealer must apply to an SRO for membership within thirty days of the date upon which the MFDA is recognized (the "Application Deadline"). Mutual fund dealers would then be required to be a member of an SRO within 12 months of the Application Deadline.

Sections 13.2 and 13.3 below set out the MFDA's proposed method of processing the large volume of applications for membership, if such a rule is passed by the above-noted provincial securities regulators. It should be noted, however, that should the rule be different than that described above, the MFDA would then have to adapt its proposed membership application review process accordingly.

13.2 **Membership Review**

The MFDA must adopt an application process designed to take into account the logistical difficulties of processing in excess of 270 applications as expeditiously as possible. The number of applications may be significantly higher however, depending upon the number of incorporated salespersons or branches that apply for membership in the "introducing dealer" category. The first step in the application process would be to require prospective members to file a comprehensive application along with supporting documentation within the Application Deadline. Assuming the MFDA is recognized on January 1, 2001, the Application Deadline would be January 31, 2001.

The MFDA will compile the information contained within all of the applications it receives into its own membership database. Based on appropriate criteria and using the information in the database, the MFDA will determine the order in which the membership applications will be processed. The applications will then be reviewed in detail by MFDA staff. If, after completion of the application review, the applicant meets the minimum MFDA membership requirements, MFDA staff will recommend an applicant for membership.

If a problem is uncovered during the application review, or if exemptions from MFDA requirements are requested, the membership assessment process will likely be delayed. For incorrect or incomplete applications, applicants will receive a deficiency notice from MFDA staff and be required to respond within a short period of time.

13.3 **Implementation Issues**

The application process summarized above assumes that all applicants will meet minimum MFDA membership criteria and securities law requirements. However, there may be a significant number of applicants that do not meet such minimum standards in varying degrees. It may be necessary, due to the volume of non-compliant applicants, to accept members on specific terms and conditions depending upon the extent and nature of their non-compliance. In addition, the MFDA may have to turn down applicants for membership if the nature and extent of their non-compliance is such that it causes serious investor protection concerns. It is anticipated that MFDA staff will spend a significant amount of time and effort (although it is impossible to determine precisely how much) in dealing with such issues. This may include discussing concerns with the applicant, analyzing responses and devising an acceptable solution. There may be situations where MFDA staff recommends that an applicant be granted a form of "conditional" membership pending satisfaction of, or demonstrated compliance with, certain MFDA or securities law requirements. It is not intended that such a "conditional" membership process would trigger the formal hearing process outlined in the draft By-laws regarding the imposition of terms and conditions.

When it is proposed that an application be rejected or terms and conditions be imposed, the applicant will have a right to request a hearing before a panel the Board in accordance with the By-laws. Applicants who have been turned down for membership by the Board will have the ability to appeal the decision to the applicable securities commission.

14 MULTI-PROVINCIAL REGULATION

Initially, the MFDA will seek formal recognition as an SRO in 3 provinces: Alberta, British Columbia and Ontario. With respect to the other provinces and territories in which many prospective members will also be carrying on business, the MFDA understands that such provinces and territories (with the exception of Quebec) will informally or formally permit

the MFDA to regulate its members' activities in their jurisdiction in a similar manner as the provinces where the MFDA is formally recognized. However, it is possible that a province may not agree, either formally or informally, to permit the MFDA to regulate its members' activities in whole or in part in its jurisdiction.

In considering accepting a mutual fund dealer as a member, the MFDA must be satisfied that the dealer's operations in all provinces in which it conducts business are subject to a suitable level of regulation and oversight. This is important for the following reasons:

- The initiative for the MFDA by the CSA and industry participants envisions a national SRO with uniform standards across the country to the extent possible as being in the best interests of public investors, mutual fund dealers and regulators.

- Members that operate in several jurisdictions generally do so as a single legal entity with multiple provincial registrations. The activities of a member's employees or agents in one province could therefore have an impact on the entire organization and could potentially cause the bankruptcy of the member.

- Members will be participating in the Investor Protection Plan which will provide coverage to clients of the member who lose property as a result of an insolvency of the member. To ensure that the risk of member insolvencies and resulting client losses are minimized, the Investor Protection Plan and the MFDA will have to be satisfied that the member's entire operations are subject to a satisfactory level of regulation and oversight.

In light of the above considerations, a mutual fund dealer will only be eligible for MFDA membership if the dealer is (a) subject to a suitable level of regulation in every province in which it operates, and (b) the MFDA and the MFDA Investor Protection Plan have sufficient discretion in every province to participate in the administration of the business of the dealer in the event of its insolvency.

A mutual fund dealer will be considered to be subject to a "suitable level" of regulation in a particular province in the following circumstances:

Participating Jurisdictions. The MFDA can directly regulate the dealer's activities in each of the provinces in which the dealer carries on business. This will require the MFDA to have either the implicit or the explicit consent of the relevant provincial securities regulatory agency to regulate and exercise authority over the dealer and its registered salespeople. In other words, the MFDA must be able to directly monitor compliance with all of its Rules and By-laws and impose sanctions in accordance with its By-laws when necessary.

Non-Participating Jurisdictions. If the MFDA is not permitted to *directly* regulate a dealer's activities in a particular province, the following two conditions must be met in order for a dealer to be eligible for MFDA membership:

(a) The MFDA and the MFDA Investor Protection Plan are both satisfied that the dealer is otherwise regulated in such province under a similar regulatory regime which results in a level of regulation that is substantially similar to the MFDA's; and

(b) The MFDA has sufficient access to the dealer's books, records and operations to be able to conduct "prudential" compliance reviews.

"Prudential" compliance reviews are intended to ensure a dealer is solvent and that client assets are being handled and accounted for properly. This involves, among other things, reviewing financial statements, reviewing trust account balances and reconciliations, and ensuring other controls and procedures are in place with respect to client assets.

It is noted that the MFDA will not likely be able to perform "business conduct" reviews of a member (i.e. reviewing supervisory procedures, account opening documentation, transactions, etc.) operating in a non-participating province, nor will it likely be able to undertake disciplinary proceedings against registered individuals operating in a non-participating province. This scenario would be acceptable for the MFDA only if another regulatory regime was already in place in that province which results in a level of regulation substantially similar to the MFDA's. This would allow the MFDA to rely upon such regulatory regime's "business conduct" reviews and disciplinary proceedings. To date, the MFDA understands that Quebec is the only non-participating jurisdiction. It is anticipated that in Quebec, the Bureau des services financiers and the Chambre de la sécurité financière will be performing the aforementioned regulatory functions. The MFDA will strive to work with these regulatory bodies with a view to ensuring consistent and harmonized regulation.

15 INFORMATION SHARING WITH PROVINCIAL SECURITIES REGULATORS

The MFDA will require some form of information sharing arrangement with all of the provincial securities regulators since it will not be delegated the authority by the securities commissions to register individuals (unlike the IDA in some jurisdictions). Such an arrangement should provide MFDA staff with the necessary access to up-to-date registration information about members, their branches and all of their registered salespersons. If any province is unwilling or unable to share registration information with the MFDA, the MFDA would not be able to verify a member's or its salespersons' registration status or other relevant registration information, such as branch locations, address, history, etc.

16 INVESTOR PROTECTION PLAN FUNDING MODEL

Details regarding the establishment of the MFDA Investor Protection Plan as described in section 7 will have to be finalized. In addition to the legal creation of the Plan entity and retention of the Plan Board, this will include a determination of coverage levels, coverage commencement, funding models and operating arrangements with CIPF. As discussed in section 7, it can be expected that individual account coverage will be determined according to the level

of assets in the Investor Protection Plan.

17 **TRANSITION PERIOD FOR MFDA RULES**

The MFDA draft Rules and By-laws do not refer to effective dates for the implementation of specific requirements. However, MFDA staff propose to recommend that the Board suspend or defer the application of certain provisions in the Rules and By-laws. The following is a list of those provisions in the draft Rules and By-laws for which MFDA staff is currently considering recommending a transition period.

(a) Draft Rule 1.2.2(b) imposes a two year experience requirement on branch managers. Certain provincial jurisdictions do not currently require branch managers to have previous relevant experience in order to be registered as a branch manager. MFDA staff propose to recommend that the effective date of this requirement be delayed for a one year period in order to allow members sufficient time to ensure all of their branch managers have the appropriate qualifications.

(b) Draft Rule 1.2.3 imposes proficiency and registration requirements on trading partners, officers and directors. These provisions mirror existing regulatory requirements. MFDA staff anticipate that a number of salespersons currently operating as branches of a dealer may wish to register in the "Introducing Dealer" category, as opposed to becoming an employee or agent of the sponsoring dealer. In order to facilitate this restructuring of their affairs and preserve the continuity of their business, a transition period of one year will be recommended. This will allow them sufficient time to restructure their operations as well as complete the requisite courses.

(c) Draft Rule 3.1.1 imposes minimum capital for designated levels of dealers. Please refer to section 10.1 of Part III hereof for a detailed discussion of the transition periods and the interim minimum capital levels which MFDA staff proposes to recommend.

(d) Draft Rule 3.5.1 requires members to file financial reports on a monthly and annual basis. MFDA staff is recommending a transition period of two years on the monthly filing requirement after the MFDA Rules are effective to ease the transition to these new financial reporting requirements. In the interim, MFDA staff will recommend that all members be allowed to file such reports on a quarterly basis only.

(e) Draft Rule 5.3.1 requires members to send an account statement to each client once every 12 months for a client name account. MFDA staff is recommending a transition period of one year on condition the member obtains assurance that that manager of the mutual fund sends the account statement containing the required information. This is in recognition of the fact that dealers in certain jurisdictions may not have been required to send account statements to their clients under their applicable securities legislation. It is recognized that dealers may still be required to comply with this requirement in some jurisdictions due to applicable securities laws.

PART V – SUMMARY OF THE SRO RECOGNITION PROCESS

As noted previously herein, the MFDA is initially planning to seek recognition as an SRO in Ontario, Alberta and British Columbia (the "Recognizing CSA Members"). Based on discussions with the Recognizing CSA Members, set out below is a summary of the significant events in the SRO recognition process for the MFDA.

PRE-PUBLIC COMMENT PROCESS

Recognition Application Process Commenced December 22, 1999	The MFDA applied to the Recognizing CSA Members for recognition as an SRO. The long term plan of the MFDA is to be recognized as an SRO in all provinces, with the exception of Quebec, on either an informal or formal basis.
Initial Review of Application by Recognizing CSA Members January-February 2000	The Recognizing CSA Members reviewed the application package and engaged in discussions with MFDA seeking clarification and/or additional commentary.
Changes to Application by MFDA March-May 2000	Based on discussions with the Recognizing CSA Members, the MFDA revised and clarified the application materials, and re-submitted the application package.
Publication of Application by Recognizing CSA Members and Commencement of Public Comment Process June 2000	The Recognizing CSA Members will publish and invite the public to make written comments on the following documents: 1. Proposed Rule of the Recognizing CSA Members requiring mandatory SRO membership for all mutual fund dealers; 2. Proposed SRO Recognition Criteria of the Recognizing CSA Members, along with MFDA commentary on the criteria; and 3. MFDA application for SRO recognition (including the draft By-Laws and Rules). The MFDA will forward its SRO recognition application to potential MFDA members and invite them to make written submissions to the Recognizing CSA Members in accordance with the public comment process. The length of the comment period for each of the above items will be determined by the CSA.

POST-PUBLIC COMMENT PROCESS

Due to the uncertainty of several factors, including (i) the precise length of the comment periods; (ii) the number of comment periods which will be required; (iii) the nature of the comments which will be received; and (iv) the amendments to the Rules, By-laws, MFDA structure, etc. which may be required; it is not yet possible to provide the dates upon which the following events will occur.

Receipt and Review of Public Comments	The MFDA and the Recognizing CSA Members will review any written submissions or inquiries received during the public comment period.
MFDA Response to Public Comments	The MFDA will publish its response to any public comments received, as well as any proposed changes to the draft By-Laws or Rules. If any of these changes are "material", another public comment period may be required by the Recognizing CSA Members.
Finalize By-Laws and Rules	Once all of the comments from the Recognizing CSA Members and the public have been considered, necessary changes will be made to the draft By-Laws and Rules. The proposed final By-Laws and Rules will then be submitted to the MFDA Board of Directors for approval.
Recognition of MFDA	Once all of the public comments have been addressed to the satisfaction of the Recognizing CSA members, and if they are of the view it is in the public interest to do so, the Recognizing CSA Members will issue an Order officially recognizing the MFDA as a self-regulatory organization.
Member Applications to MFDA (in the period (i.e. one month) after the official recognition date)	Applications from potential MFDA members will be received, accompanied by an application deposit.
Review and Processing of Member Applications (in the period (i.e. 12 months) after all applications have been received)	The MFDA will review the applications received from prospective MFDA members. If the application is accurate and complete and the applicant satisfies MFDA membership criteria, the MFDA will accept the dealer as a member.

APPENDIX A - GLOSSARY AND DEFINITIONS

" approval" or **"approved"** means, in respect of members of the MFDA or their partners, directors, officers, shareholders, employees or other entities, such members or persons who have been approved by the MFDA, its staff, Board, councils or committees, as the case may be, under the Rules.

"Approved Person" means, in respect of a member, an individual who is a partner, director, officer, compliance officer, branch manager, assistant or co-branch manager, employee or agent of the member who is registered under the applicable securities legislation and is designated and qualified as such in accordance with the Rules or who is otherwise subject to the jurisdiction of the MFDA.

"ASA" means the *Securities Act*, S.A. 1981, c. S-6.1 (as amended).

"ASC" means the Alberta Securities Commission.

"AUA" means assets under administration.

"BCSA" means the *Securities Act*, R.S.B.C. 1996, c. 418 (as amended).

"BCSC" means the British Columbia Securities Commission.

"Board" means the board of directors of the MFDA.

"Books and Records Committee" means the Books, Records and Administration Committee established by the MFDA as one of the Industry Committees and referred to in Section 2.5.

"By-laws" means any By-law of the MFDA from time to time in force and effect.

"Capital and Contingency Committee" means the Capital, Contingency and Insurance Committee established by the MFDA as one of the Industry Committees and referred to in Section 2.5.

"CCA" means the *Canada Corporations Act*, R.S.C. 1970, c. C-32.

"CDIC" means the Canada Deposit Insurance Corporation.

"CIPF" means the Canadian Investor Protection Fund which is the compensation fund for customers of insolvent securities dealers who are members of the IDA, The Toronto Stock Exchange, Montreal Exchange and the Canadian Venture Exchange.

"Commissions" means provincial and territorial securities commissions and regulatory authorities which are members of the CSA.

"CSA" means the Canadian Securities Administrators representing the provincial securities commissions.

"Description" means this document entitled the

'Description of the Structure and Self-Regulating Activities of the MFDA.'

"Distribution Structures Committee" means the Distribution Structures Committee established by the MFDA as one of the Industry Committees and referred to in section 2.5.

"IDA" means the Investment Dealers Association of Canada which is an unincorporated association of its members which are investment dealers and brokers located in all provinces and territories of Canada.

"IFIC" means The Investment Funds Institute of Canada which is a not-for-profit corporation formed under Part II of the CCA.

"Industry Committee" means one of the committees established by the Board of the MFDA and referred to in section 2.5.

"Investor Protection Plan" means the MFDA Investor Protection Plan established for customers of insolvent members and referred to in section 7.

"INWM Model" means the Integrated National Wealth Management Model described in section 5.5.3.

"MFDA" means the Mutual Fund Dealers Association of Canada/Association canadienne des courtiers de fonds mutuels which is a not for profit corporation formed under Part II of the CCA and is intended to be established as a self-regulatory organization for mutual fund dealers in the provinces and territories of Canada (other than the Province of Quebec).

"members" means, in respect of the MFDA, persons, firms or corporations which have been admitted or accepted as members of the MFDA.

"NASD" means the National Association of Securities Dealers, Inc. in the United States.

"OSA" means the *Securities Act*, R.S.O. 1990, c. S.5 (as amended).

"OSC" means the Ontario Securities Commission.

"Plan" means the MFDA Investor Protection Plan.

"Proficiency Committee" means the Proficiency and Continuing Education Committee established by the MFDA as one of the Industry Committees and referred to in Section 2.5.

"Proposed Criteria" means the recognition criteria prepared by the Recognizing CSA Members and provided to the MFDA, which must be satisfied by the MFDA in order to be recognized as an SRO under applicable legislation.

"provincial securities legislation" means the relevant securities legislation of the provinces and territories in Canada.

"Provincial Plans" means the investor protection plans established for clients of registrants under provincial securities legislation in British Columbia, Ontario, Quebec and Nova Scotia.

"recognition" means recognition of the MFDA as an SRO (or similar standing) by a Commission in applicable jurisdictions.

"Recognizing CSA Members" means the Alberta, British Columbia and Ontario Securities Commissions to which the MFDA will initially apply for recognition as an SRO.

" Rules" means the Rules made pursuant to the By-laws and any form prescribed thereunder.

"Sales Practices Committee" means the Sales Practices and Compliance Committee established by the MFDA as one of the Industry Committees and referred to in section 2.5.

"SRO" means a self-regulatory organization which is an organization established by members of a particular industry imposing on themselves and enforcing regulatory standards for the conduct of their business.

"staff" means the officers and employees of the MFDA.

"Stromberg Report" means the report by former Ontario Securities Commissioner, Glorianne Stromberg, entitled "Regulatory Strategies for the Mid-90s: Recommendations for Regulating Investment Funds in Canada".

"**Support Agreement**" means the agreement between IDA and the MFDA by which the IDA has agreed to provide to the MFDA, certain services of its President, staff, office facilities, regulatory services and administrative services, and referred to in section 2.7.

APPENDIX B – CSA PROPOSED CRITERIA FOR RECOGNITION OF THE MFDA AS AN SRO

The Recognizing CSA Members have prepared and provided to the MFDA draft criteria (the "Proposed Criteria") which must be satisfied by the MFDA in order to be recognized as an SRO under applicable legislation. The Proposed Criteria, together with the MFDA's commentary thereon, will be published by the CSA for public comment.

Set out below are (i) a summary of the Proposed Criteria, and (ii) the MFDA's response or commentary as to how it will satisfy the Proposed Criteria. The MFDA commentary is largely derived from either Part II of this Description entitled, "The MFDA as an Organization", or directly from the draft By-laws or draft Rules.

CSA PROPOSED CRITERIA AND MFDA RESPONSE

A. STATUS

1.1 The MFDA is a "self-regulatory organization" as defined in the applicable securities legislation, it is organized for the purposes set forth therein and its rules are binding on its members.

MFDA Commentary: The MFDA was incorporated as a non-share capital corporation under Part II of the Canada Corporations Act ("CCA") on June 19, 1998. The primary constating document of the MFDA is its letters patent which provides for its name, initial incorporators and directors, objects and powers. The objects of the MFDA are set out in detail in its letters patent. The primary objects are summarized as follows:

- to encourage through self-regulation a high standard of conduct among members with regard to mutual fund distribution in Canada;
- to regulate members of the MFDA and persons who are or were shareholders, partners, directors, officers or employees of such members;
- to establish requirements for membership in the MFDA and the approval of individuals in respect of such members, and to monitor and enforce such requirements;
- to investigate, mediate and arbitrate grievances pertaining to the public, members and approved persons;
- to establish and maintain a compensation or protection fund for clients of members; and
- to facilitate members conferring amongst themselves on matters of common concern, including consultation and co-operation with governments, regulators, etc.

1.2 *It is non-profit.*

MFDA Commentary: As a corporation without share capital, the MFDA must carry on its objects and activities without pecuniary gain to its members and, upon winding up, its assets may not be distributed to its members, but are to be distributed to one or more organizations with objects similar to those of the MFDA. Subject to appropriate reserves, it is expected that the MFDA's revenues will be offset by its expenses, and it will not have net income that is subject to income tax.

B. ***GOVERNANCE AND STRUCTURE***

1.3 1.3.1 Its arrangements with respect to the appointment, removal from office and functions of the persons ultimately responsible for making or enforcing the rules of the MFDA, namely the Board of Directors, (the "Board") are such as to secure a proper balance between the interests of the different members of the MFDA, and in recognition that the protection of the public interest is a primary goal of the MFDA, an appropriate proportion of directors consist of persons representing the public.

MFDA Commentary: Section 3.4.1 of the draft By-laws provides that at any time one third of the directors shall be nominees of the IDA, one third shall be nominees of IFIC (one of which IFIC nominees must be a director, officer or employee of a mutual fund distributor which is not a member of IFIC) and one third shall be public directors (i.e. persons who are not directors, partners, officers or employees of a member, or their associates or affiliates).

1.3.2 Without limiting the generality of the foregoing, the MFDA's governance structure reflects the agreement between the IDA and IFIC in respect of the establishment of the MFDA and provides for:

(a) the rights of the IDA and IFIC to each nominate an equal number of members of the Board;

MFDA Commentary: As noted above, section 3.4.1 of the draft By-laws provides that the IDA and IFIC shall each nominate an equal number of directors. Nominees of each of the IDA and IFIC may be appointed and removed from time to time by each of those organizations as they see fit and in accordance with the procedures set out in the By-laws.

(b) a nominating committee of the Board whereby the remaining directors, who would be independent from the securities industry, and who would represent the public, would be nominated;

MFDA Commentary: Section 3.10 of the draft By-laws provides for a Governance Committee of the Board. Public directors are nominated by the Governance Committee and elected by the directors (including public directors) on a staggered basis for two year terms, with a maximum of three consecutive terms pursuant to section 3.5.2 of the draft By-laws.

(c) an executive committee;

MFDA Commentary: As provided for in section 3.8 of the draft By-laws, the Board has appointed an Executive

Committee comprised of two nominees of the IDA, two nominees of IFIC and two public directors.

> *(d) equal representation by nominees of the IDA, IFIC and the public directors on key MFDA committees, including the executive committee;*

MFDA Commentary: Under section 3.11 of the draft By-laws, the Board may appoint committees of the Board provided that each committee shall have equal representation by nominees of the IDA, IFIC and the public directors. To date, the Board has appointed an Executive Committee, a Governance Committee, an Audit Committee and a Compensation Committee.

> *(e) appropriate qualifications, remuneration and conflict of interest provisions for directors and appropriate limitation of liability and indemnification protections for directors, officers and employees of the MFDA generally;*

MFDA Commentary:

Qualifications for Directors - All directors must be at least 18 years old and, as noted above, section 3.4.1 of the draft By-laws requires that one-third of the directors be nominees of IFIC; one-third be nominees of the IDA and one-third be public directors.

Remuneration – Section 3.12 of the draft By-laws provides that the directors, except for public directors, shall serve as directors without remuneration and shall not directly or indirectly receive any benefit or profit from occupying the position of director. Public directors are entitled to receive reasonable remuneration as determined by the Board from time to time. All directors are entitled to be reimbursed for reasonable expenses incurred by them in performing their duties for the MFDA.

Limitation of Liability – Section 8.1 of the draft By-laws provides that no director, officer, employee or agent of the MFDA is responsible for the acts or defaults of any other director, officer, employee or agent or for any loss occasioned by any error in judgement or oversight on his or her part, provided that nothing relieves any director or officer from the duty to act in accordance with the CCA or from any liability for any breach thereof.

Indemnity - Directors, officers, employees and agents of the MFDA are entitled to indemnification out of the funds of the MFDA in accordance with section 8.2 of the draft By-laws against costs and expenses sustained in any action, suit or proceedings which is brought in respect of the execution of his or her duties, and all other costs which he or she sustains except those that are occasioned by his or her own wilful neglect or default.

Conflicts of Interest – Directors are also subject to the provisions set out in section 6 of the draft By-laws with respect to interested director contracts. A director who is in any way directly or indirectly interested in a contract or a proposed contract with the MFDA must make the disclosure required under the CCA and no such director may vote on any resolution to approve any such contract.

Insurance – Section 8.3 of the draft By-laws permits the MFDA to purchase and maintain insurance for the benefit of directors, officers and employees. Accordingly, insurance has been arranged in terms and amounts that have been considered prudent in the circumstances.

> *(f) a chairman, president, chief executive officer, chief operating officer, persons responsible for the functions of senior compliance officer, senior policy officer and senior enforcement officer and other officers, all of whom, except for the chairman, are independent of any member.*

MFDA Commentary: Section 7 of the draft By-laws provides that the directors shall appoint certain officers of the MFDA. Officers are subject to removal by resolution of the Board from time to time. The duties and responsibilities of the respective officers of the MFDA are determined in accordance with the By-laws and the terms of their appointment.

The draft By-laws provide that the Chairman of the MFDA shall be the Chairman of IFIC and the President and Chief Executive Officer of the MFDA shall be the President of the IDA. The draft By-laws further provide that the President and Chief Executive Officer of the MFDA shall have the responsibility for general supervision of the business of the MFDA and such other powers and duties as the Board may specify. The Chief Operating Officer was appointed by the Board and reports to the President and Chief Executive Officer of the MFDA, and shall manage the staff of the MFDA and carry out the administrative functions that are required for the operations of the MFDA. The Board may appoint one or more Vice-Presidents, a Secretary, a Controller and any other officers as it may deem appropriate.

Upon recognition, the MFDA will have a Vice-President, Member Regulation, who will be responsible for managing the overall compliance, enforcement and policy functions of the MFDA. For each of these areas, the MFDA will have a Director responsible for managing each department. In addition, the MFDA will also have regional offices in Alberta and British Columbia upon recognition. Each office will initially be staffed with a Regional Director. The regional offices will be responsible for monitoring the members' activities in the region.

Each MFDA employee will be required to sign a business conduct statement upon being hired whereby the employee agrees not to participate in the ownership of, or receive benefits from, a member.

*C. **FEES***

1.4 1.4.1 The MFDA has sufficient means of raising revenues from its members to satisfy its responsibilities.

MFDA Commentary: The operations of the MFDA will be financed generally by fees charged to members in respect of annual fees. The Board will have the authority to determine such fees, as provided for in section 14 of the draft By-laws.

1.4.2 Fees imposed by the MFDA on its members are equitably allocated and bear a reasonable relation to the costs of regulating such members. Fees do not have the effect of creating barriers to membership, and fees are organized in such a manner that they do not discourage increased capital, provided that fees may be based on assets under administration, member revenues, number of employees, use of services, actual costs incurred or other reasonable parameters.

MFDA Commentary:

The MFDA fee model is discussed in Section 5.5.2 of Part II of the Description and a summary is attached at Appendix C to the Description. A summary of the development of the MFDA fee model is attached at Appendix D. The fee model was developed after an extensive consultation process with potential members of the MFDA, the Executive Committee of the Board of Directors of the MFDA, the MFDA Board of Directors, MFDA Staff and PricewaterhouseCoopers ("PwC"). The MFDA began with the development of an operating model that would best suit the regulation of mutual fund dealers. Based on the operating model, a detailed budget and business plan were developed. The business plan budgets for an annual revenue requirement of $12 million over the five-year projection period. The fee model was developed to determine how the MFDA would allocate its $12 million annual funding requirement amongst its members.

The Board developed a number of revenue principles which set out the objectives for the fee model. PwC was then asked to present the various options for calculating fees (including an analysis on the extent to which each option met the Board's revenue principles) to potential members in British Columbia, Alberta and Ontario. Thirteen workshops were held in May 1999. Based on the feedback received from the workshops, PwC concluded that consensus was not possible due to the number of constituencies within the potential MFDA membership and their divergent views. However, it was the majority view that an assets under administration ("AUA") approach was a fair and reasonable model.

The Board then requested further input from the industry as to whether money market funds should be included in the definition of AUA and whether an economies of scale concept should be incorporated into the fee model. A questionnaire was sent by the MFDA to potential members with a request for comments on these issues. Again, there was no consensus on the approach that should be adopted with respect to these issues. As a compromise, the Board approved a fee model that included money market funds in the definition of AUA, but also incorporated an "economies of scale" concept with respect to establishing the applicable fee rate.

Fee Calculation - On June 30th every year (the MFDA's fiscal year-end) MFDA members will be required to calculate their average assets under administration using the simple average of the closing assets of June 30th of the prior year and the closing assets of June 30th of the current year. However, the basis for calculating the assets under administration may be altered in the future to a more frequent calculation.

Fee Rate - Fee rates will be set by the MFDA Board annually to meet the financial requirements of the MFDA.

Minimum Fees - Minimum fees of $3,000, or in the case of a carrying dealer $10,000, will be payable if the fees calculated under the above model are less than $3,000 or $10,000, as the case may be.

1.4.3 The costs of the operations of the MFDA will be borne by industry participants, through fees or other levies and will ensure the MFDA Protection Plan will be adequately funded.

MFDA Commentary: The MFDA Financial Projection (the "Financial Projection") assumes that the MFDA will generate sufficient funding to operate as an SRO after recognition through membership fees. In addition, under section 15 of the draft By-laws the Board will have the power to make an assessment upon each member on account of levies made by an MFDA Investor Protection Plan in accordance with the terms of the agreement establishing such Plan.

Please refer to section 5.5.2 of Part II of the Description for a more detailed discussion of the MFDA fee model. Please refer to section 7 of Part II of the Description for a detailed discussion of the MFDA Investor Protection Plan.

D. MEMBERSHIP

1.5 The MFDA's Rules permit all properly registered dealers who satisfy the membership criteria to become members thereof and provide for the non-transferability of membership. The MFDA's membership criteria provide for:

1.5.1 reasonable financial and operational requirements, including minimum capital and capital adequacy, adequate debt subordination arrangements, protection fund participation in the MFDA Protection Plan, bonding and insurance, record-keeping, new accounts, knowledge of clients and suitability of trades, supervisory practices, segregation and protection of clients' funds and securities, the operation of cash accounts, risk management and internal control procedures, compliance procedures (including a written compliance program), client statements, settlements, order taking, order processing, account inquiries, confirmations and other back office requirements generally;

MFDA Commentary: The MFDA will implement a regulatory regime that includes rules that govern activities relating to the trading of securities as well as the conduct of members in other respects. A dealer and its directors, officers, partners, employees and agents, in order to be eligible to apply for membership, must agree to comply with the By-laws, Rules, Policies and Forms of the MFDA. The MFDA's Rules will specifically provide for: financial and operations requirements (including minimum capital, segregation of client property, financial reporting, early warning and audit requirements); insurance requirements; business conduct requirements (including new account requirements, minimum standards of

conduct and supervision requirements); and books, records and client reporting requirements (including client statements and trade confirmations). With respect to the non-transferability of membership, please refer to the commentary below in relation to ownership, changes of ownership and reorganizations of members. Please also refer to sections 5.6 through 5.9 of Part II of the Description.

1.5.2 reasonable proficiency requirements (including training, education and/or experience) with respect to partners, directors, officers, employees and agents;

MFDA Commentary: Section 1.2 of the draft Rules sets out proficiency requirements for registered individuals, which includes partners, directors, officers, compliance officers, branch managers and salespeople. In addition to completing the course requirements, newly-registered salespersons will be required to complete a training program within 90 days of carrying on activities with a dealer, and will be subject to a concurrent six month period of enhanced supervision. Please also refer to section 8.2 of Part III of the Description.

1.5.3 consideration of ownership of the applicant under the criteria established for purposes of paragraph 6 hereof;

MFDA Commentary: Subsection 11.4.3(b) of the draft By-laws provides that the Board may refuse an application for membership if, among other things, the applicant is not qualified by reason of the ownership and integrity of the applicant or any person having an ownership interest in the capital or indebtedness of the applicant.

1.5.4 consideration of discipline history, including breaches of applicable securities laws, the rules of other self regulatory organizations, or MFDA rules, prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally of the applicant and any partners, directors and officers, in order that membership may, where appropriate, be refused where any of the foregoing have previously engaged in improper conduct, and shall be refused where the past conduct of any of the foregoing affords reasonable grounds for belief that the applicant's business would not be conducted with integrity; and

MFDA Commentary: Subsection 11.4.3(a) of the draft By-laws provides that the Board may refuse an application for membership if, in the opinion of the Board, having regard to such factors it may consider relevant, including the past or present conduct of the applicant, it is not satisfied that the By-laws and Rules will be complied with. Please also refer to section 5.4 of Part II of the Description.

1.5.5 reasonable consideration of relationships with other members and other business activities to ensure the appropriateness thereof.

MFDA Commentary:

Relationships With Other Members - Pursuant to section 11.4.3 of the draft By-laws, the Board may refuse an applicant if, among other reasons, the applicant is not qualified by reason of the ownership of the applicant or by reason of any person having an ownership interest of the capital or indebtedness of the applicant, or if such approval is not otherwise in the public interest. In addition, section 13.7 of the draft By-laws provides that the MFDA must be informed of any reorganization, transfer or amalgamation of a member's business with another person (including another member) if the business will be substantially changed from its current form, or if a change of control of the member may occur. Please also refer to sections 5.6 to 5.9 of Part II of the Description.

Other Business Activities - Under the Board's general discretion to refuse an applicant if such approval is not in the public interest, the MFDA will ensure that any commercial activities carried on by an applicant or a member do not prejudice the primary object of regulation of mutual fund dealers. Members must always avoid potential conflicts of interest and ensure that engaging in such other activities does not impair their ability to properly service clients or fulfill the obligations of a member. In this regard, the draft Rules provide that neither a member nor its representatives may engage in any activity that would be unbecoming of a MFDA member or detrimental to the public interest. See section 9 of Part III of the Description.

E. OWNERSHIP (AND CHANGES OF OWNERSHIP) OF MEMBERS

1.6 The MFDA's rules require prior MFDA approval to acquire a material registered or beneficial ownership interest in securities, indebtedness or other ownership interests in members, directly or indirectly, to become a transferee of such interests, and in respect of business combinations, mergers, amalgamations, redemptions or repurchases of securities, dissolutions and acquisitions of assets. Each case is subject to appropriate exceptions in the case of publicly traded securities, de minimis transactions that do not involve changes in de facto or legal control or the acquisitions of material interests or assets, and non-participating indebtedness. The MFDA rules also provide for approval in respect of all persons who satisfy criteria providing for:

1.6.1 consideration of discipline history, including breaches of applicable securities laws, the rules of other self regulatory organizations, or MFDA rules, prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally, in order that approval may, where appropriate, be refused where the person or company or any of its partners, directors or officers have previously engaged in improper conduct, and shall be refused where the past conduct of any of the foregoing affords

reasonable grounds for belief that the business would not be conducted with integrity;

1.6.2 reasonable consideration of relationships with other members and other business activities to ensure the appropriateness thereof; and

1.6.3 refusal of approval in the absence of agreement to submit to the jurisdiction of the MFDA and to comply with its rules, to notify the MFDA of any changes in his, her or its relationship with the member or of any involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or in civil proceedings involving business conduct or alleging fraudulent conduct or deceit thereafter, to accept service by mail in addition to any other permitted methods of service, to authorize the MFDA to co-operate with other regulatory and self-regulatory organizations, including sharing information with these organizations, and to provide the MFDA with such information as it may from time to time request and full access to and copies of any and all records.

MFDA Commentary: As noted above in the discussion of relationships with other members, section 13.7 of the draft By-laws provides that the MFDA must be informed in advance of any reorganizations, transfers or amalgamations of a member's business, in whole or in part with another person (including another member) if the business will be substantially changed from its current form, or if a change in control of a member may occur. The Board has the general discretion under this section of the draft By-laws to refuse a transfer, amalgamation or reorganization of a member's business or the ownership of a significant equity interest of a member if it is not satisfied that the By-laws and Rules would be complied with. Section 13.9 of the draft By-laws also provides that the MFDA must receive advance notice of and pre-approve any transactions that permit an investor to hold a significant equity interest (at least 10% of the outstanding voting securities) of a member. Please also refer to sections 5.6 through 5.9 of Part II of the Description. Section 11.4.3 of the draft By-laws provides that the Board may refuse an application if it is not satisfied that the Rules and By-laws will not be complied with, or the applicant is not qualified by reason of solvency, integrity, training or experience or if it is not in the public interest. Rule 1.2.5 requires every member to notify the MFDA of certain changes, including material changes in any other information previously filed with the MFDA, such as a charge or indictment against such member pursuant to any criminal laws or securities legislation, or the member being declared bankrupt or making a voluntary assignment into bankruptcy or having a receiver or manager appointed to hold its assets. The MFDA draft Policy entitled "Handling Client Complaints" requires each member to report to the MFDA any client complaint involving allegations of theft or misappropriation of funds or securities, or forgery. Section 24 of the draft By-laws provides that the MFDA may enter into information-sharing agreements or other forms of mutual assistance with other regulatory and self-regulatory organizations.

F. APPROVED PERSONS

1.7 The MFDA's rules require a member to confirm with the MFDA that persons that it wishes to sponsor, employ or associate with as a partner, director, officer or salesperson of a member (collectively, "Approved Persons") comply with applicable securities legislation and are properly registered.

The relationships between MFDA members and their Approved Persons will be limited according to permitted distribution structures as outlined in the Distribution Structures Paper.

MFDA Commentary:

Qualifications for Approved Persons - Approved persons are, in addition to completing the courses required under the draft Rules for their category of registration, also required to be registered and/or licensed under the applicable securities legislation and must agree to comply with, be subject to and bound by the MFDA By-laws and Rules. Please refer to section 8.2 of Part III of the Description.

Relationship between Member and Approved Person: As noted above, the draft Rules set out the permitted relationships between members and their approved persons (i.e. employer/employee and principal/agent), which prescribed relationships are consistent with the provisions of the CSA Distributions Structures Paper. Please refer to section 8.1 of Part III of the Description for details of permitted structures.

G. DISCIPLINE OF MEMBERS AND APPROVED PERSONS

1.8 The rules of the MFDA provide that its members and their Approved Persons shall be appropriately disciplined for violations of applicable securities laws and of the rules of the MFDA. The rules of the MFDA provide for discipline to include censure, fine, suspension, bar, expulsion, limitation of activities, payment of costs and any other appropriate sanctions. The Commission shall be forthwith notified of any and all disciplinary proceedings following the issuance of a notice of hearing, and of the disposition of any and all disciplinary proceedings and of all settlements. Automatic or summary intervention shall apply where necessary to protect investors, clients, creditors, members, the MFDA Protection Plan or the MFDA.

MFDA Commentary:

Penalties: Sections 21 through 25 of the draft By-laws set out the investigation, hearing and discipline procedures that will apply to members if a member has committed any of the violations described in section 25.1 of the draft By-laws. Violations include engaging in business conduct unbecoming a member or not in the public interest, and failing to comply with the Rules, By-laws and Policies of the MFDA or with the provisions of any applicable federal or provincial statute. Please refer to section 6 of Part II of the Description for a description of the MFDA's proposed investigation and disciplinary powers and hearing process.

1.9 The rules of the MFDA enable it to prevent the resignation of a member from the MFDA from

becoming effective if the MFDA considers that any matter affecting the member, or any registered or beneficial holder of an ownership interest in securities, indebtedness or other ownership interests in members, directly or indirectly (and persons or companies associated or affiliated therewith), or members' Approved Persons, should be investigated or that the member or any such person or company should be disciplined.

MFDA Commentary: A member wishing to resign from the MFDA must follow the procedures set out in sections 13.1 through 13.6 of the draft By-laws. This includes a requirement for the member to file certain financial information along with an auditor's report. The Board has the discretion under section 13.4 of the draft By-laws to refuse a resignation.

1.10 *Members will be subject to the review, enforcement and disciplinary procedures of the MFDA. MFDA staff will also review the activities of the personnel of MFDA members (partners, directors, officers and salespersons). Although members will be responsible for the conduct of all their personnel (whether approved and/or registered), personnel who are not required to be approved or registered will not generally be subject to the MFDA's enforcement jurisdiction.*

MFDA Commentary: Members will be required to maintain compliance systems in order to ensure that the member and its approved persons are in compliance with applicable requirements. In addition, members (as well as the activities of individual partners, directors, officers and salespersons) will be subject to the review, enforcement and disciplinary procedures of the MFDA. The MFDA will exercise its jurisdiction over members and their personnel in several contexts including initial application for membership, monitoring of compliance with the Rules on an ongoing basis and, when necessary, investigating alleged non-compliance and taking enforcement action to require compliance or impose discipline. Although the member will be generally responsible for the conduct of all its personnel (whether or not they are approved), personnel who are not required to be approved or registered will not generally be subject to the MFDA's enforcement jurisdiction. Please also refer to section 6 of Part II of the Description.

H. DUE PROCESS

1.11 *The rules of the MFDA relating to admission to membership, the imposition of limitations or conditions on membership and denial of membership are fair and reasonable, including in respect of notice, an opportunity to be heard or make representations, the keeping of a record, the giving of reasons and provision for appeals.*

MFDA Commentary: Individuals, firms or corporations who wish to become members of the MFDA are required to meet certain basic eligibility criteria set out in the draft Rules and draft By-laws. Admittance to membership will be by process of application. The application procedures set out in section 11 of the draft By-laws will ensure that the applications are considered fairly and that applicants will have recourse in the case of adverse decisions by the MFDA Board. A panel or committee of the Board will be appointed to consider membership applications. If this panel/committee proposes to refuse an application or impose terms and conditions that are adverse to the applicant, it will offer the applicant an opportunity to be heard before it makes its decision. Ultimately, decisions of the Board will be subject to review by the provincial or territorial securities regulator having jurisdiction under applicable securities legislation. Please also refer to sections 5 and 6 of Part II of the Description.

1.12 *The rules of the MFDA relating to the discipline it exercises over members and Approved Persons are clear, fair and reasonable, including provisions regarding what constitutes misconduct, notice, an opportunity to be heard or make representations, utilizing independent hearing officers, the keeping of a record, the giving of reasons and provision for appeals, provided that they shall provide for summary and/or automatic suspension in specified circumstances where necessary to protect investors, members, the MFDA Protection Plan or the MFDA, with a prompt right to a hearing after any summary and/or automatic suspension. The rules of the MFDA provide that the public is to be given notice of disciplinary matters (including, for greater certainty, proposed settlements) not less than 14 days prior to the date of the hearing in respect thereof (with names and a summary of facts); hearings shall be open to the public (except where required for the protection of confidential matters); and that the disposition of the matter including settlements is made public.*

MFDA Commentary: Section 25 of the draft By-laws provides for a transparent, clear and fair disciplinary process satisfying all of the above criteria. Please refer to section 6 of Part II of the Description for a discussion of this process.

1.13 *All decisions of the MFDA and its Board of Directors, regional councils or other committees with respect to members and their personnel will be subject to hearing and review by the Commission. Staff of the Commission will monitor the enforcement proceedings of the MFDA by way of receipt of regular reports and, on request, disclosure of the facts and circumstances of particular cases.*

MFDA Commentary: Pursuant to section 25.17.2 of the draft By-laws, decisions of regional councils with respect to members may be appealed to a panel of the MFDA Board. All decisions of the MFDA, its Board and regional councils with respect to members and their personnel will be subject to a hearing and review by applicable members of the CSA who have assumed jurisdiction in that regard. In addition, persons who have been directly affected by decisions of the MFDA may, in the appropriate circumstances, have recourse to the CSA or the civil courts.

Sections 25.3.4 and 25.16 of the draft By-laws require the MFDA to deliver to the applicable securities regulatory authorities all notices of hearings or notices of penalty issued by the MFDA. Please refer to section 6 of Part II of the Description. Please also refer to the commentary below for a further discussion of information sharing and co-operation arrangements with various regulatory authorities including members of the CSA.

I. INFORMATION, REPORTING AND OTHER REQUIREMENTS APPLICABLE TO MEMBERS

1.14 Without limiting the generality hereof, the rules of the MFDA seek, at a minimum:

1.14.1 to require that each member must at all times provide the MFDA with any and all information requested by it concerning the member's activities and full access to and copies of any and all records in respect thereof and authorize the MFDA to co-operate with other regulatory and recognized self-regulatory organizations;

MFDA Commentary:

Access to Records - Members are required under section 23 of the draft By-laws to provide the MFDA, for the purpose of any examination or investigation, any and all information and documentation regarding a member's or their personnel's activities and no member or person may withhold, destroy or conceal any information, document or thing reasonably required for the purpose of such examination or investigation. In addition, under section 5.6 of the draft Rules, the MFDA will have access to all books and records of a member that are required to be kept and maintained in accordance with the Rules and By-laws. Please also refer to section 12 of Part III of the Description.

Request for Information - Members that are requested by any securities commission or regulatory authority, law enforcement agency or self-regulatory organization to provide information in connection with an investigation into trading in securities, are required under section 24.1 of the draft By-laws to submit such information as may be reasonably prescribed by such authority.

Co-operation - The MFDA is authorized under section 24.2 of the draft By-laws to enter into agreements with other regulatory authorities, including law enforcement agencies, for mutual assistance for market surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities in Canada and elsewhere. Under section 24.3 of the draft By-laws, the MFDA may also provide to any securities commission, law enforcement agency or regulatory authority any information obtained by the MFDA pursuant to the By-laws or Rules or otherwise in its possession and may provide other forms of assistance for surveillance, investigation, enforcement and other regulatory purposes relating to the trading of securities in Canada or elsewhere.

1.14.2 to ensure that the requirements of paragraphs 5, 6 and 7 are satisfied both initially and on an ongoing basis, including with respect to sub-paragraph 5(a) by the provision on an ongoing basis of audited annual and unaudited interim financial reports, capital reports and management letters and other appropriate information to the MFDA;

MFDA Commentary: Under section 3.5 of the draft Rules, each member must file monthly unaudited financial reports and an annual audited financial report through the member's auditor. However, the MFDA proposes to allow quarterly reporting for the first two years after the MFDA is recognized, as a transition period in order for members to have time to adapt to monthly reporting. Please also refer to section 10.5 of Part III of the Description.

1.14.3 to provide for an adequate early warning reporting system to alert the MFDA to possible financial problems at members and a system to alert the MFDA of other operational or financial difficulties that could adversely affect investors, clients, creditors, members, the MFDA Protection Plan or the MFDA, including requirements for a member's auditor to report material breaches of MFDA rules concerning, at a minimum, the calculation of the member's financial position, the member's handling and custody of money and securities and the maintenance of adequate records by the member;

MFDA Commentary:

Early Warning - Section 3.4 of the draft Rules sets out the early warning reporting system that will apply to MFDA members. A member may be designated in early warning level 1 or 2 according to its capital, profitability and liquidity position from time to time, or at the discretion of the MFDA as provided in the Rules. Please also refer to section 10.4 of Part III of the Description.

Reporting Material Breaches - Under section 3.6.6 of the draft Rules, if a member's auditor observes during the conduct of his or her audit any material breach of the By-laws or Rules pertaining to the calculation of the member's financial position, handling and custody of securities and maintenance of adequate records, he or she must make a report to the MFDA. Please also refer to section 10.6 of Part III of the Description.

1.14.4 to provide for immediate reporting to the MFDA by members of risk-adjusted capital deficiencies and/or their failure to properly maintain their books and records;

MFDA Commentary: If, at any time the risk adjusted capital required to be maintained by the member is less than zero, section 3.1.2 of the draft Rules requires the member to notify the MFDA immediately.

1.14.5 to require members to reconcile segregated securities and report to the MFDA thereon on a quarterly basis;

1.14.6 to require members to provide to clients upon request statements of their financial summary;

MFDA Commentary: Under the draft Internal Control Policies, a member must determine at least monthly, the market value and number of all securities required to be segregated for clients, and perform monthly reconciliations to identify deficiencies. In the event that a securities segregation deficiency exists, if the deficiency is not corrected within 30 days, the member must purchase the securities. Cash segregation deficiencies must be funded by the member immediately. The monthly financial report required to be filed

by members will contain information with respect to any segregation deficiencies. Please also refer to section 10.5 of Part III of the Description.

1.14.7 to prevent improper use and dissemination of confidential information respecting investors; and

MFDA Commentary: Draft Rule 2.1.3 sets out confidentiality requirements with respect to clients and the business and affairs of clients. Please also refer to section 9.3 of Part III of the Description.

1.14.8 to prohibit the use of improper sales literature and, if and where appropriate, to monitor or regulate the use of sales literature generally.

MFDA Commentary: Requirements with respect to advertising and sales communications are set out in draft Rule 2.7. There is a general requirement that no member may issue to the public or knowingly allow its name to be used in respect of any advertisement or sales communication that is untrue or misleading. In addition, no advertisement or sales communication may be issued unless first approved by a partner, director, officer or branch manager who has been designated by the member as being responsible for advertisements and sales communications. Please also refer to section 9.3 of Part III of the Description. The MFDA will monitor members' compliance with these Rules through the compliance examinations it conducts on members.

J. PURPOSE OF RULES

1.15 1.15.1 The rules of the MFDA are designed:

(a) to ensure compliance with applicable securities laws;

(b) to prevent fraudulent and manipulative acts and practices and to promote the protection of investors, just and equitable principles of trade and high standards of operations, business conduct and ethics;

(c) generally to promote public confidence and public understanding of the goals and activities of the MFDA, to educate the public about mutual fund investment generally and to improve the competence of members and their Approved Persons;

(d) to standardize industry practices where appropriate for investor protection;

(e) to permit the MFDA to monitor the financial service activities, that are not subject to another regulatory regime, conducted by its members;

(f) to provide for the administration of the affairs of the MFDA; and

(g) for such other purposes as may be approved by the Commission;

and shall not:

(h) permit unfair discrimination among investors, mutual funds, members or others; or

(i) impose any burden on competition that is not appropriate in furtherance of the above purposes.

1.15.2 Unless otherwise approved by the Commission, the rules of the MFDA governing the carrying on of mutual fund distribution business by its members afford investors protection at least equivalent to that afforded by the relevant securities laws, provided that, for greater certainty, higher standards in the public interest are permitted and encouraged.

MFDA Commentary: The draft By-laws and draft Rules are designed to address the principles set out in sub-paragraph *(a)* above. With respect to sub-paragraph *(b)* above, the requirements set out in the draft Rules afford investors protection at least equivalent to that afforded by applicable securities laws, and in many areas higher standards are imposed than that which currently exist under applicable securities laws.

K. RULE-MAKING

1.16 No new rules or changes to rules (which shall include any revocation in whole or in part of a rule) shall be made effective by the MFDA without prior approval of the Commission and any such rules or changes shall be justified by reference to the permitted purposes thereof (having regard to paragraph 13 hereof) and shall be subject to a memorandum of understanding between the Commission and the MFDA ("Protocol") to be established regarding the review and approval of by-laws, rules, regulations, policy statements and amendments thereto. The Protocol shall cover when the Commission will require new rules or changes to rules to be published for comment.

1.17 Prior to proposing a rule or rule change, the board of directors of the MFDA shall have determined that the entry into force of such rule or rule change would be in the public interest and every proposed rule and rule change must be accompanied by a statement to that effect.

MFDA Commentary: The MFDA understands that a condition of recognition will be that all Rules and amendments thereto will be subject to compliance with a CSA 'Protocol' of the nature referred to above. Further, the Board is aware of the public interest mandate of the MFDA. Please also refer to sections 2.2.3 and 4.2 of Part II of the Description.

L. OPERATIONAL ARRANGEMENTS AND RESOURCES

1.18 The MFDA has adequate arrangements and resources for the effective monitoring and enforcement of compliance with applicable securities laws and with its rules. With the consent of the Commission, the arrangements for monitoring may make provision for

one or more parts of that function to be performed on behalf of the MFDA (and without affecting its responsibility) by any other body or person who is able and willing to perform it. The Commission's consent may be varied or revoked from time to time and may be subject to terms and conditions.

1.19 The MFDA can respond promptly and effectively to public inquiries and generally has effective arrangements for the investigation of complaints (including anonymous complaints) against its members or their respective personnel. Such arrangements may make provision for one or more parts of that function to be performed on behalf of the MFDA (and without affecting its responsibility) by any other body or person who is able and willing to perform it, with the consent of the Commission, which consent may be varied or revoked from time to time and may be subject to terms and conditions.

1.20 The arrangements and resources referred to in sub-paragraphs 1.18 and 1.19 above consist at a minimum of:

(a) sufficient qualified staff, including professional and other appropriately trained staff;

(b) an adequate supervisory structure;

(c) adequate management information systems;

(d) a compliance department and an enforcement department, each with appropriately trained staff and with appropriate reporting structures directly to senior management, and, in the case of the compliance department, both regular examination and surprise examination procedures, and all such procedures shall be in writing wherever practicable;

(e) procedures and structures that minimize or eliminate conflicts of interest at the MFDA;

(f) procedures to gather information on market practices;

(g) inquiry and complaint procedures and a public information facility, including with respect to the discipline history of particular persons or companies;

(h) guidelines regarding appropriate disciplinary sanctions; and

(i) the capacity and expertise to hold disciplinary hearings (including regarding proposed settlements) utilizing independent hearings officers.

1.21 A satisfactory review by or on behalf of the Commission of the arrangements and resources referred to in sub-paragraphs 1.18 through 1.20 above shall precede any recognition.

MFDA Commentary: The MFDA believes that all of the foregoing criteria are or will be addressed. Reference is made to the Financial Projection, the draft By-laws and the draft Rules.

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APPENDIX C — SUMMARY OF MFDA FEE MODEL

The MFDA was established with the goal of becoming a national self-regulatory organization ("SRO") for mutual fund dealers in Canada. The MFDA will generate sufficient funding to operate as an SRO by collecting membership fees. The following summarizes the MFDA's fee calculation and collection process.

! Calculation of Membership Fees

- ÿ Membership fees will be calculated each year according to a formula prescribed by the MFDA Board of Directors.
- ÿ MFDA Members will be required to calculate their average assets under administration ("AUA") as of June 30th in each calendar year.
- ÿ Average AUA is the simple average of the closing assets of June 30th of the prior year and the closing assets of June 30th of the current year.
- ÿ MFDA membership fees will be equal to the MFDA fee rates multiplied by the Member's average AUA.

! Assets Under Administration ("AUA")

- ÿ AUA is defined as the market value of all investment products reflected in the client accounts (nominee or client name) of a Member, including but not limited to:
  - mutual funds
  - securities
  - segregated funds
- ÿ AUA includes assets in all provinces of Canada, excluding Québec, in which the member distributes such products.
- ÿ AUA does not include:
  - cash
  - deposit instruments (GIC's)
  - limited partnerships

! Minimum Fees

- ÿ Minimum MFDA Membership fees are $10,000 for carrying dealers and $3,000 for all other Members.

! Determination of MFDA Fee Rates

- ÿ The MFDA Board of Directors will set the fee rates annually, in accordance with the financial requirements of the MFDA. The fee rates will be applied to Members' AUA by graduated "tiers". The current rates are:
  - Tier 1 = MFDA Fee Rate of $65 on first $500 million of AUA
  - Tier 2 = MFDA Fee Rate of $61 on next $500 million of AUA
  - Tier 3 = MFDA Fee Rate of $56 on next $4 billion of AUA
  - Tier 4 = MFDA Fee Rate of $52 on next $5 billion of AUA
  - Tier 5 = MFDA Fee Rate of $49 on amounts in excess of $10 billion of AUA

! Payment of Fees - First Year

- ÿ Membership fees for the first year will be *pro-rata* based on the date of acceptance into membership.
- ÿ A refundable deposit will be required to accompany the Application for Membership and will be applied towards the Member's annual fees upon acceptance into membership.

! Payment of Fees - After First Year

- ÿ MFDA membership fees will be paid in quarterly instalments. Each payment is to be made within 15 days of the end of each calendar quarter (i.e. April 15th, July 15th, October 15th and January 15th).

! Exemption Process

- ÿ A process will be established whereby Members may apply to the MFDA in appropriate circumstances for exemptions for relief from annual fees. Such a process may accommodate organizations that are in a transitional stage of restructuring their operations.

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APPENDIX D — SUMMARY OF THE DEVELOPMENT OF THE FEE MODEL

Overview

This summary outlines the processes that were followed in the development of the MFDA's fee model ("Fee Model"). The Fee Model was developed after extensive consultation with potential members of the Mutual Fund Dealers Association of Canada ("MFDA"), the Executive Committee of the Board of Directors of the MFDA, the Board of Directors of the MFDA ("Board"), MFDA Staff and PricewaterhouseCoopers ("PwC").

The creation of the MFDA began with the development of an operating model that would best suit the regulation of mutual fund dealers. Based on the operating model, a detailed budget and business plan was developed.

The business plan budgets for an annual revenue requirement of $12 million over a five-year projection period. The two main components of the budget are:

(a) operating costs of approximately $9 million; and
(b) repayment of the costs required to establish the MFDA of $3 million.

The Board requested that a fee model be established to raise sufficient funds from membership fees to meet the financial requirements of the MFDA. As part of this process, the following steps were completed:

- The Board created a series of revenue principles (Schedule 1) which set out the objectives of the Fee Model.
- In January 1999, the Board was presented with a draft business plan that outlined the approach to the development of the operating and fee models.
- The Board recommended that input from potential members should be incorporated into any potential fee model.
- The Board retained PwC to consult with potential members through a series of workshops that were held in the three initial recognizing provinces of Ontario, Alberta and British Columbia. These workshops were completed in May 1999.
- PwC presented the results of the workshops and the proposed Fee Model to the Board in June 1999. The Board required further consultation relating to the definition of Assets under Administration ("AUA") and how to account for economies of scale when setting the MFDA Fee Rate.
- Recommendations and comments of the Board were incorporated into a member comment paper in August 1999 ("Member Comment Paper"). The Member Comment Paper was distributed to approximately 300 mutual fund dealers in the three initial recognizing provinces in August 1999. The primary purpose was to obtain additional feedback from potential members on the definition of AUA and on economies of scale.
- Member comments were received, reviewed, summarized and presented to the Board in September 1999. The Board asked PwC to construct simulated models with different levels of money market fund inclusion and economies of scale to assist the Board in its final decision.
- During the comment period process, the MFDA become aware of another model being proposed whereby MFDA operating revenues would be collected and remitted by mutual fund companies directly to the MFDA. The model is in the development stage and involves aspects other than MFDA funding. Nevertheless, the Board recognized that the model contained several positive aspects and accordingly, has established a committee to monitor its development for future consideration. The model has been called the Integrated National Wealth Management Model ("INWM Model").
- PwC presented the results, as requested, to the Board in November 1999. After considering the models presented, the Board approved the full inclusion of money market funds in the calculation of AUA and the incorporation of economies of scale concept into the MFDA Fee Rate.
- The Fee Model will be reviewed and is subject to change as the MFDA and industry develops.

MFDA Revenue Principles

The MFDA initially created a series of revenue principles ("Principles") that set out the objectives of the Fee Model. These Principles were used as a guide in the initial creation of possible fee models. During the evaluation and review stage, the Principles were used to measure the effectiveness of each model and to ultimately rank each model.

At the request of the Board, the Principles were presented to potential members through a series of workshops and subsequently through the Member Comment Paper. Listed below is a summary of the Principles which are set out in full in Schedule 1 herein:

- **Fairness:**
  The cost of self-regulation should be passed on to members on an equitable basis (i.e. generally, all else being equal, larger members will require more regulatory resources than smaller members, and therefore, should pay higher fees).
- **Stability:**
  The MFDA must have a stable revenue stream to allow it to operate on an efficient, effective and continuous basis.
- **Consistently Applied:**
  The basis on which the fee is calculated should be the same for all members.
- **Proportionate:**
  A member should pay fees proportionate to the benefits it receives from being regulated by, and being a member of, the MFDA.
- **Practicality:**
  The method used to calculate and collect fees should be easy to administer.
- **Reliability:**

The fee calculation should be easily verifiable.

Fee Model Development

There are four main concepts that impact the method of determining fees for each member. A significant amount of time was spent analyzing these concepts against the Principles. The concepts are:

1. **Ranking of members:**
   How to determine the smallest to the largest members within the membership?

2. **Allocation of fees:**
   How fees should be allocated to the smallest to largest members (i.e. does the basis stay constant or change depending on size?)

3. **Minimum fees:**
   Should there be a minimum fee that a member pays regardless of its size. If so, what should the minimum fee be?

4. **Fixed or Variable:**
   Do the fees have fixed ranges or should they vary proportionately to the size of the organization?

Potential Fee Models

The most important concept is the ranking of members. Based on this concept, the following six ranking fee models were analyzed:

Model 1 - Ranking by Member:
Each member would be treated equally and would be charged the same fee.

Model 2 - Ranking by Number of Salespersons:
A per salesperson fee would be charged.

Model 3 - Ranking by Gross Revenue:
MFDA fees would be based on a percentage of the member's gross revenue.

Model 4 - Ranking by AUA:
MFDA fees would be based on a percentage of the member's AUA.

Model 5 - Ranking by Gross Sales:
Fee calculation would be based on a percentage of the member's gross sales of mutual funds.

Model 6 - Ranking by Operational Complexity:
Fee calculation would be based on an assessment of the operational complexity of a member's operations. Factors affecting operational complexity include the products offered (i.e. mutual funds, limited partnerships), the services offered (i.e. financial planning), the number of jurisdictions in which the member is registered and the number of branches and sub-branches of the member.

The analysis of the models included reviewing each approach on a stand-alone basis and reviewing combinations of approaches (blended approach) in order to determine which approach **best meets the Principles.**

As previously mentioned, another model was brought to the Board's attention whereby the MFDA would receive operating revenues directly from mutual fund companies (the INWM Model). This model is in the development stage and will be monitored for future consideration.

Membership Workshops

After the initial analysis was completed, a series of workshops was scheduled in order to solicit input from potential MFDA members. The workshops were designed to gather ideas and perspectives while at the same time gaining an understanding of preferences towards fee model concepts.

Participation

In total, thirteen workshops were conducted during a three-week period in late April and early May, 1999. Workshop participants were identified through the registration lists maintained by the Ontario, Alberta and British Columbia Securities Commissions. Mutual fund dealers were contacted and invited to attend a half day session.

Of the 270 potential members invited, approximately 45% or 125 organizations participated in the workshop sessions. The various constituencies (financial institutions, independents, investment counsel firms, and mutual fund companies) were well represented, including representation across the various sizes of organizations.

Outline

Each session was conducted by PwC and was similarly structured to ensure consistency and comparability of input. The outline of each workshop session was as follows:

1. **MFDA Overview:**
   Reviewed the development of the MFDA's organization, business pl an, operating budget and committees.

2. **Revenue Principles:**
   Reviewed the Principles created by the Board.

3. **Industry Trends:**
   Participants provided their views on industry trends (to assist with designing a fee model which is relevant now and into the future).

4. **Fee Model Discussion and Feedback:**
   - **!** Introduced the main concepts required to develop the fee model.
   - **!** Reviewed six alternatives to rank membership.
   - **!** Reviewed the six ranking models, discussed the process used to eliminate four of the six and obtained input from the participants.
   - **!** Discussed final top fee models – AUA and gross sales.

Summary of Workshop Results

The purpose of the participant workshops was to allow for full participation by potential members prior to deciding upon a fee model. A summary of feedback obtained at the workshops is outlined below:

- **Consensus on this topic was not possible** due to the number of constituencies (i.e. categories of members) within the potential membership and their divergent views.

- The majority of participants felt that a model based on AUA was a reasonable and fair model for assessing membership fees. In addition, they believed that AUA was an easily obtainable and a verifiable number.

- The other ranking model in which participants expressed interest was a model based on a per salesperson charge. This model was preferred mainly because it would allow certain dealers to easily pass on costs to their salespersons.

- All participants recognized the need to rank and tier members to ensure the levels of membership fees are fair and appropriate.

- The majority of participants agreed that a minimum fee was appropriate, and generally felt that it should be in the $2,000 - $3,000 range.

- Another generally, accepted concept was to pay fees on a “dollar for dollar” basis (e.g. $50 fee per one million dollars worth of assets).

- The vast majority of participants were in agreement with the idea that the “complexity of operations” was highly correlated to regulatory risk. However, there was no consensus among the potential membership as to the relative complexities or how to integrate it into the fee model.

Fee Model Analysis

The Board reviewed each of the concepts presented by PwC and evaluated each potential solution against the Principles. The Board took into consideration the feedback received from the potential members who attended the workshops as well as the input from PwC. The Board identified “fairness” and “stability” to be the most important Principles in determining the Fee Model. Understanding the demographics of the MFDA membership was important in evaluating whether a particular model will significantly impact the ability of a segment of the membership to pay MFDA fees (fairness) or the stability of the model.

The Board considered the AUA approach to be the model that best fits the Principles. The analysis of AUA against each of the Principles and the potential membership’s views are outlined below:

Fairness

The industry is moving quickly towards an asset management business and away from one driven primarily by the execution of transactions. The ability of a member to pay fees will be increasingly influenced by the asset base it is managing. Therefore, the AUA approach is more consistent with the changing environment and should be fairer both now and in the future.

An asset-based model also reflects the developed stage of the industry. With over $350 billion of AUA and millions of existing investors, it is important that fees paid by a member somehow fairly reflect its current position in the industry. It was considered reasonable that one of the fairest measures of a member’s current position is that of its asset base. In addition, its large asset base reflects a large base of investors who require regulatory protection. Therefore, the model based on AUA is fair since mutual fund dealers with more AUA, and therefore, a corresponding larger number of investors and higher revenues will pay higher MFDA fees.

The model must also be structured so that it treats smaller and newer members of the MFDA fairly. The proposed model, with a minimum fee of $3,000 and a ranking by AUA, was not felt to be excessive, such that smaller members would be forced out of the industry. The AUA model ensures that fees would grow as members have increased economic ability to pay the fees, thereby reducing the likelihood that the fee structure would become a barrier to entry.

Stability

There is a possibility that consolidation amongst mutual fund dealers will continue to occur over the next few years. In addition, the continuously changing approaches to distributing mutual funds may also lead to changes in the mutual fund dealer industry. For example, on-line trading and the use of call centers is becoming more popular. These changes may lead to changes in the environment but are not felt to affect the overall level of assets within the industry. Therefore, the AUA model strongly supports this important Principle.

It is noted however, that AUA has some instability due to changes in the revenue streams related to market valuation fluctuations of the underlying AUA. The participants of the workshops expressed this view. However, the impact of changes to underlying AUA can be decreased by averaging the opening and closing AUA and, if necessary, the MFDA Fee Rates can be adjusted to ensure the Fee Model generates the required annual revenue.

Consistently Applied

All members can consistently apply the AUA model since application of the calculation does not need to be adjusted across the membership.

Proportionate

The AUA model tends to link financial resources available for industry regulation to the actual size of the industry. In addition, if the premise is that the purpose of regulation is to protect investors’ interests, then AUA is an extremely strong model since there is a high correlation between the assets managed and the number of investor accounts.

Practicality

Calculating MFDA Fees using AUA is easy to administer. Once a mutual fund dealer has calculated its average AUA, it only needs to apply the MFDA Fee Rates set by the Board against its average AUA to determine its MFDA fees. Workshop feedback also indicated that AUA is an easily obtainable number.

Reliability

AUA can be relied upon, since verification of mutual fund assets by member can be obtained directly from mutual fund companies, when required.

Member Comment Period

The objective of the final consultation with potential members was to ensure that all issues were considered fully before the Board concluded on a final Fee Model. The purpose of the Member Comment Paper was to communicate and to solicit comments from the future membership.

The Member Comment Paper contained an overview of the approach taken in the development of the Fee Model to date. It also contained an overview of the recommended Fee Model based on AUA and the two outstanding issues that were open for comments.

The outstanding issues were:

a) the definition of AUA for the purposes of calculating the MFDA fees for a member; and
b) the incorporation of the concept of "Economies of Scale" for establishing the MFDA Fee Rate.

Potential members were instructed to provide comments on these two issues and to relate all comments to the Principles, since the final Fee Model would be the one that best supported these Principles.

Definition of AUA

General definition of AUA: All investment funds under the administration of mutual fund dealers. This definition could include, but was not limited to, mutual funds, segregated funds (sold through the member), limited partnerships and other investment vehicles sold under prospectus offering to retail clients.

Potential members were asked to focus on the following issues:

- Are there certain asset classes that should be excluded from the definition?
- How should each of the asset classes be valued for purposes of the membership fee calculation?
- How should asset classes such as limited partnerships be valued?

In addition, potential members were asked if money market funds should be included in the calculation of average AUA (i.e. should the MFDA be charging a fee based on a class of assets for which members receive little or no revenue and should money market funds be exempt from fees or incur a lower fee?).

Economies of Scale

Potential members were asked to consider if a decreasing incremental fee structure (a tiered approach) should be applied as mutual fund dealers' AUA reaches larger sizes (i.e. economies of scale – would result in a lower relative fee for larger organizations). It was explained that this could be achieved by having a declining per asset charge depending on the size of the asset base.

In addition, potential members were asked to consider the amount of the discounted fee to be allocated to larger organizations and define how large a member should be in order to qualify for the discount. They were also told that if a discounted fee were given to large members, it would follow that the smaller members who would not qualify for the discount would end up paying additional fees in an aggregate amount equal to the discount given to the larger members.

Summary of the Membership Comment Paper

Comments received by the MFDA were summarized by constituency for the Board. The comments of each constituency are also summarized below.

There are a number of individual constituents whose views differ, at least in part, from the overall position held by their constituencies. Although there was a number of other issues raised by potential members, for purposes of this summary, the focus is on the two outstanding issues of the definition of AUA and on whether to incorporate economies of scale into the model.

Financial Institutions:

Financial institutions support the exclusion of money market funds from the AUA definition, or at a minimum, support the application of a lower fee rate to be applied to money market funds. In addition, many financial institutions suggest that a reduced fee be applied to those mutual funds that generate little or no management fees. With respect to the application of the principal of "economies of scale", they believe that such a principle should be applied in the Fee Model.

Investment Counsel Firms:

Investment counsel firms support the exclusion of all institutional account assets and discretionary private assets from the AUA definition. Investment counsel firms suggested that consideration be given to scaling the fees down as the assets grow.

Independent Mutual Fund Dealers:

- The **large and medium-sized** independent mutual fund dealers are generally opposed to a fee model based on AUA and instead favour a per salesperson fee model. Few of these firms commented on the specific issues addressed in the comment paper. Of the firms that did provide comments on the issues, some supported a definition of AUA which included all asset classes without discrimination and opposed economies of scale.

- **!** Among the **smaller i**ndependent mutual fund dealers there was some support for a fee model based on AUA, as well as support for a fee model based on a per salesperson charge. The majority of firms who provided comments on the definition of AUA believe the definition should include money market assets. With regard to the economies of scale issue, the majority opposes charging larger members a proportionately lower fee than smaller members, based on the principles of fairness, consistency and practicality.

Each constituency has issues with the AUA model and there was no single constituency that felt that all of its circumstances were fully addressed by the recommended model. As per the earlier results, it was apparent that no consensus could be reached among the constituencies.

Based on the comments received, it was clear that the issues with respect to the inclusion of money market funds and economies of scale could not be resolved through consensus.

Given the lack of consensus among potential members, the Board requested PwC to simulate potential fee models and the effect of these models on the members with respect to including or excluding money market funds and incorporating tiered rates to account for economies of scale. The purpose of the analysis was to assist the Board in finalizing its decision on money market funds and economies of scale.

Presentation to and Approval by the Board

The Board was presented with several models[2] with respect to the two following outstanding issues:

a) the inclusion of money market funds in the calculation of AUA; and
b) the incorporation of the concept of economies of scale into the MFDA Fee Rate.

The models were analyzed in relation to the Principles and findings from the workshops and the comment period. After considering the models presented, the Board approved the full inclusion of money market funds in the calculation of AUA for members. The Board also approved the inclusion of economies of scale into the MFDA Fee Rate.

Overall Approval by the Board

The Board believes that the Fee Model based on AUA is the most appropriate model with which to rank the MFDA membership and establish the MFDA Fee Rate. The AUA model is the one that best meets the Principles initially set out by the Board and provides:

1. Fairness to the membership as members with more AUA will pay more fees and other members are not at a disadvantage for being small;
2. Stability as the industry matures;
3. A relatively low amount of effort to administer the model, and;
4. A good measure for the number of investors whom the MFDA regulations and compliance effort will be designed to protect.

The Board also approved the establishment of a committee to monitor the development of the INWM Model.

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1 Models and analysis were based on information and statistics for April 1999 as provided by IFIC.

Schedule 1 - MFDA Revenue Principles

The MFDA developed a series of Principles which have guided the development of the Fee Model. These Principles are as follows:

A. **Benefits to the Member**. A member should pay fees proportionate to the benefits it receives from being regulated by, and being a member of, the MFDA.

Cost of Regulation

In accordance with the above principle, the cost of regulation should be borne by the members on a proportionate basis. The costs of regulation associated with a particular member can be affected by many factors such as:

1. **Size of the Member's Business**
   Generally, larger members will require more regulatory resources than a smaller member (assuming everything else is equal, i.e. each member is in compliance with MFDA regulations).

2. **Risk and/or Complexity of the Member's Operations**
   The risk and/or complexity of the member's operations varies based on a number of factors, such as:
   - **!** The number of jurisdictions in which the member operates. (Proximity to head office may affect the member's ability to effectively supervise operations in other jurisdictions).
   - **!** The number of branches and salespersons registered by the member. (All else being equal, regulatory risk increases proportionately with increases in a member's sales force).
   - **!** The nature of the member's internal operations. (For example, a member administering its own self-directed RRSP poses a greater regulatory risk than a member that decides not to take on such added responsibility).
   - **!** The nature of the products and services offered to clients. (For example, a member that sells limited partnerships poses a greater regulatory risk than a member that does not sell such products).

Other Benefits associated with MFDA membership

1. **Goodwill** Members of the MFDA will realize a certain amount of goodwill, simply by the mere fact of their membership. Members will benefit from the positive image of belonging to a self-regulatory organization.

2. **Level Playing Field** The creation of the MFDA will standardize regulatory requirements for every mutual fund member in the industry. Members will have to comply with minimum standards and each member will be reviewed to ensure adherence with those standards.

3. **Communications** The MFDA will clearly communicate detailed rules, policies and regulations necessary to maintain membership and comply with securities laws. In addition, the MFDA will communicate changes, interpretations, updates, guidelines and disciplinary proceedings to members in the form of bulletins.

4. **Regulatory Harmonization** The MFDA will harmonize regulatory requirements for mutual fund dealers operating in the provinces in which the MFDA is recognized as a SRO.

5. **Investor Protection Fund** The MFDA will require participation in a contingency fund for the sole purpose of protecting investors against the bankruptcy of a mutual fund dealer. Members will be able to advertise their participation in the fund to clients.

B. **Ability to Pay**
The basic membership fees should not be prohibitively high, acting as a barrier to entry into the business.

C. **Precedents and Comparisons**
If appropriate comparisons can be made, the principles upon which the MFDA's fees are based, as well as the actual amount, should be consistent with fee systems of other self regulatory bodies such as the IDA and NASD.

D. **Fees must cover the Cost of Adequate Regulation**
The aggregate fees received by the MFDA from its members must be sufficient to cover the cost of what is believed, in the public interest, to be the necessary and appropriate level of regulation.

E. **Stable Revenues**
The MFDA must have a stable revenue stream to allow it to operate on an efficient, effective and continuous basis.

F. **Economic Activity** A member's fees should reflect the overall level of economic activity of the member. Factors such as gross sales or gross revenues would be relevant.

G. **Blended Approach**
Since reliance on one factor may create unfairness to a particular industry segment and/or create an unstable flow of revenues for the MFDA, consideration should be given to a model that relies on a combination of factors (i.e. gross revenues, number of salespersons, etc.). In addition, tiers should be developed to stratify the membership into various categories reflecting the regulatory effort required for each tier. However, since every organization will require some amount of regulatory effort, there should be a minimum fee established.

H. **Administrative Ease**

The method used to calculate and collect membership fees should not be so complicated as to incur significant costs and resources by both the MFDA and members.

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Draft: June 9, 2000
FOR PUBLICATION

MUTUAL FUND DEALERS ASSOCIATION OF CANADA/
ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS

BY-LAW NO. 1

(as amended by By-law No. 3)

NOTE TO READER: This draft By-law of the Mutual Fund Dealers Association of Canada / Association canadienne des courtiers de fonds mutuels (MFDA) has been prepared for comment in connection with the application of MFDA for recognition as a self-regulatory organization pursuant to applicable provincial securities legislation. The By-law, together with the Rules, Forms and Policies of MFDA, is based on statutory requirements, the recommendations of the Board of Directors and various MFDA Industry Committees, current industry practices, the standards of similar self-regulatory organizations and the announced requirements of securities regulators. Further amendments may be made as MFDA develops and regulatory policy for MFDA Members is determined. The application of some sections of the draft By-law may be delayed for limited periods of time to permit orderly transition and compliance by Members and Approved Persons.

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BY-LAW NO. 1
(as amended by By-law No. 3)

being the General By-law of

MUTUAL FUND DEALERS ASSOCIATION OF CANADA/ ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS
(hereinafter referred to as the "Corporation")

INTERPRETATION AND EFFECT

1. **Definitions**. In this By-law, unless the context otherwise specifies or requires:

"Act" means the *Canada Corporations Act*, R.S.C. 1970, c. C-32 as from time to time amended and every statute that may be substituted therefor and, in the case of such substitution, any references in the By-laws of the Corporation to provisions of the Act shall be read as references to the substituted provisions therefor in the new statute or statutes;

"affiliate" or "affiliated corporation" means in respect of two corporations, either corporation if one of them is the subsidiary of the other or if both are subsidiaries of the same corporation or if each of them is controlled by the same person;

"Annual Meeting" means the Annual Meeting of the Corporation;

"applicable" in relation to a Regional Council means the Regional Council for the Region:

(1) in which the applicant for Membership or the Member has its principal office;

(2) in which a Member has a branch office;

(3) in which the respondent, if an individual in a disciplinary action pursuant to Section 25, was approved at the time the activities which are the subject of the disciplinary action primarily occurred, provided that,

(a) if the individual was approved in more than one Region at the relevant time, and the matter which is the subject of the disciplinary action involves a client in a Region where the respondent was approved other than that in which the respondent resides, then in which such client resided at the time such activities occurred; or

(b) if the applicable Regional Council cannot otherwise be determined, then in which the respondent resided at the relevant time; or

(4) in which the activities which are the subject of a disciplinary action against a respondent Member pursuant to Section 25 primarily occurred, or, if such activities are not referable to any specific Region, in which the principal office of the respondent Member is located, provided that, if a disciplinary action involves both an individual and a Member, the Regional Council having jurisdiction pursuant to clause (3) herein.

"Approved Person" means, in respect of a Member, an individual who is a partner, director, officer, compliance officer, branch manager, assistant or co-branch manager, employee or agent of the Member who conducts or participates in the dealer business of the Member and who (i) is registered, licensed or approved in the appropriate category, where required by applicable securities legislation, by the securities commission having jurisdiction, and (ii) is designated and qualified as such in accordance with the Rules, or (iii) is otherwise subject to the jurisdiction of the Corporation;

"assets under administration" means the assets under administration of the business of a Member as prescribed by the Board of Directors from time to time in accordance with Section 14.1;

"associate", where used to indicate a relationship with any person, means:

(i) any corporation of which such person beneficially owns, directly or indirectly, voting securities carrying more than 10 per cent of the voting rights attached to all voting securities of the corporation for the time being outstanding;

(ii) a partner of that person acting on behalf of the partnership of which they are partners;

(iii) any trust or estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar capacity;

(iv) any relative of such person, including his/her spouse, or his/her spouse who has the same home as such person;

but where the Board of Directors orders that two persons shall, or shall not, be deemed to be associates, then such order shall be determinative of their relationships in the application of By-laws, Rules and Forms, with respect to that Member;

"Board of Directors" means the board of directors of the Corporation and any committee or panel of directors appointed by the Board under the By-laws with the authority to exercise any powers of the Board of Directors;

"branch office" means any office or location from which any dealer business of a Member is conducted;

"By-laws" means any By-law of the Corporation from time to time in force and effect;

"carrying dealer" means a Member that carries customer accounts in accordance with Rule 1.1.6 to the extent, at a minimum, of clearing and settling trades, maintaining books and records of customer transactions and the holding of client cash, securities and other property;

"client name" means in respect of an account or client property, an account established by a Member for a client in accordance with the By-laws and Rules, and the cash, securities or other property held for such account, where the cash, securities and property is held in the name of and by a person other than the Member;

"**control" or "controlled"**, in respect of a corporation by another person or by two or more corporations, means the circumstances where:

(i) voting securities of the first-mentioned corporation carrying more than 50% of the votes for the election of directors are held, other than by way of security only, by or for the benefit of the other person or by or for the benefit of the other corporations; and

(ii) the votes carried by such securities are entitled, if exercised, to elect a majority of the Board of Directors of the first-mentioned corporation,

and where the Board of Directors orders that a person shall, or shall not, be deemed to be controlled by another person, then such order shall be determinative of their relationships in the application of the By-laws, Rules and Forms with respect to that Member;

"Corporation" means Mutual Fund Dealers Association of Canada \ Association canadienne des courtiers de fonds mutuels, a corporation incorporated pursuant to the Act, and any reference in the By-laws, Rules and Policies to an act being or to be performed by the Corporation shall be deemed to be a reference to the Corporation acting through any duly authorized director, officer, employee or agent of the Corporation;

"dealer business" means any business or activity (whether or not carried on for gain) engaged in, directly or indirectly, which constitutes:

(a) trading or advising in securities for the purposes of applicable securities legislation in any jurisdiction in Canada, including for greater certainty, securities sold pursuant to exemptions under application securities legislation;

(b) the provision of financial planning services[1]; or

(c) trading in deposit instruments;

but, notwithstanding the foregoing, shall not mean any business or activity which is, or which is carried on by or through a person which is, regulated by any governmental authority or statutory agency other than a securities commission; provided that the Board of Directors may from time to time in its discretion include in, or exclude from, this definition any business or activity of a Member or class of Members, and change from time to time those businesses or activities that are included or excluded;

"financial year" or **"fiscal year"** means the annual financial period of the Corporation ending on June 30 in each year unless changed by the Board of Directors;

"firm" means a partnership, or other form of unincorporated business organization approved as such by the Corporation;

"Form" means a form prescribed or provided for by the By-laws, Rules or Policies;

"guaranteeing" includes becoming liable for, providing security for or entering into an agreement (contingent or otherwise) having the effect or result of so becoming liable for or providing security for a person, including an agreement to purchase an investment, property or services, to supply funds, property or services or to make an investment primarily for the purpose of directly or indirectly enabling such person to perform its obligations in respect of such security or investment or assuring the investor of such performance;

"IDA" means The Investment Dealers Association of Canada;

"IFIC" means The Investment Funds Institute of Canada;

"individual" means a natural person, other than an individual who is a Member;

"introducing dealer" means a Member that introduces customer accounts to a carrying dealer in accordance with Rule 1.1.6;

"Letters Patent" means the letters patent and any supplementary letters patent of the Corporation;

"Member" means a member of the Corporation;

"Member corporation" means an incorporated Member;

"Membership" means membership in the Corporation;

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[1] [Note: Consistent with proposed Multilateral Instrument 33-107 of the CSA, the MFDA will consider a member or Approved Person to be "providing financial planning services" if they are:

(i) using any of the titles, or combination of titles, referred to in the Instrument, or

(ii) providing written financial plans as referred to in the Instrument.

The MFDA will publish an interpretation bulletin to this effect. Please also refer to Section 3.2.4 of the Description of the Structure and Self-Regulating Activities of the MFDA.]

"mutual fund dealer" means a person registered or licensed by a securities commission to deal in mutual fund or investment fund securities, other than a securities dealer;

"nominee name" means, in respect of an account or client property, an account established by a Member for a client in accordance with the By-laws and Rules in which the securities or other property is held by or in the name of the Member, or its agent or custodian, for the benefit of the client;

"Notice of Hearing" means a notice of hearing given pursuant to Section 25.3;

"officer" means the chairman or any vice-chairman of the board of directors, the president, any vice-president, the secretary, the assistant-secretary, the treasurer, the assistant treasurer, the comptroller or the general manager of a Member, or any other person designated an officer of a Member by by-law or similar authority;

"ownership interest" means all direct or indirect ownership of the securities of a Member;

"person" means an individual, a partnership, or corporation, a government or any department or agency thereof, a trustee, any unincorporated organization and the heirs, executors, administrators or other legal representatives of an individual;

"Policies" means the guidelines, policies, bulletins, notices and other communications developed and issued pursuant to Section 26.4;

"previous director" means a director referred to in Section 3.7.

"public director" means a director referred to in Section 3.4.1;

"Region" means any geographic area in Canada designated by the Board of Directors as a Region of the Corporation in accordance with Section 17.1.

"Regional Annual Meeting" means the annual meeting of Members of a Region held in accordance with Section 18.2;

"Regional Council" means a council established pursuant to Section 19 of the By-laws;

"Regulations" means the regulations made under the Act as from time to time amended and every regulation that may be substituted therefor and, in the case of such substitution, any references in the By-laws of the Corporation to provisions of the regulations shall be read as references to the substituted provisions therefor in the new regulations.

"related company" means a sole proprietorship, partnership or corporation which:

(i) is a Member; and

(ii) is related to a Member in that either of them, or their respective partners, directors, officers, shareholders and employees, individually or collectively, have at least a 20% ownership interest in the other of them, including an interest as a partner or shareholder, directly or indirectly, and whether or not through holding companies;

provided that the Board of Directors may, from time to time, include in, or exclude from this definition any person, and change those included or excluded;

"Rules" means the Rules made pursuant to Section 26 and any Forms prescribed thereunder;

"securities commission" means in any jurisdiction in Canada, the commission, person or other authority authorized to administer any legislation relating to trading in securities and/or to the registration or licensing of persons engaged in trading securities;

"securities dealer" means a person acting as dealer (principal) or broker (agent) in carrying out transactions in securities and commodity futures contracts or options on behalf of clients and includes, without limitation, acting as an underwriter or adviser, but excludes a person registered or licensed as a mutual fund dealer;

"securities legislation" means any legislation relating to trading in securities in Canada enacted by the Government of Canada or any province or territory of Canada and includes all regulations, rules, orders or other regulatory directions made pursuant thereto by any authorized body including, without limitation, a securities commission;

"sub-branch" means any branch office having in total less than four Approved Persons and supervised by an Approved Person as required under the Rules who is not normally present at such sub-branch office;

"subordinated debt" means any debt the terms of which specify that its holder will not be entitled to receive payment if any payment to any holder of a senior class of debt is in default;

"subsidiary", in respect of a corporation and another corporation, means the first mentioned corporation if:

(i) it is controlled by:

(a) that other; or

(b) that other and one or more corporations each of which is controlled by that other; or

(c) two or more corporations each of which is controlled by that other; or

(ii) it is a subsidiary of a corporation that is that other's subsidiary;

2. **Interpretation**. This By-law, the Rules and the Policies shall be, unless the context otherwise requires, construed and interpreted in accordance with the following:

2.1 **Act and Regulations.** All terms contained herein and which are defined in the Act or the Regulations shall have the meanings given to such terms in the Act or such Regulations.

2.2 **Words Importing the Singular.** Words importing the singular number only shall include the plural and vice versa; and the word "person" shall include individuals, bodies corporate, corporations, companies, partnerships, syndicates, trusts and any number or aggregate of persons.

2.3 **Words importing any gender.** Words importing gender shall include all genders.

2.4 **Headings.** The headings used in this By-law, the Rules and Policies are inserted for reference purposes only and are not to be considered or taken into account in construing the terms or provisions thereof or to be deemed in any way to clarify, modify or explain the effect of any such terms or provisions.

2.5 **References**. Unless otherwise specified or the context requires, references to Sections in the By-laws and Rules shall be references to the Sections of this By-law 1.

2.6 **Interpretation of the Board of Directors**. In the event of any dispute as to the intent or meaning of the Letters Patent, By-Laws, Rules or Forms, the interpretation of the Board of Directors, subject to the provisions of Section 27.1, shall be final and conclusive.

DIRECTORS AND OFFICERS

3. **Directors.**

3.1 **Duties and Number.** The affairs of the Corporation shall be managed by a Board of Directors. Subject to Section 3.3, the number of directors on the Board shall be a minimum of three and a maximum of 21, provided that it shall in any event be an integral multiple of three.

3.2 **Qualifications**. Every director shall be at least 18 years of age.

3.3 **First Directors**. The four applicants for incorporation shall become the first directors of the Corporation whose term of office on the Board of Directors shall continue until their successors are elected at the first meeting of Members. The Board of Directors then elected shall replace the first directors named in the Letters Patent.

3.4 **Composition of the Board of Directors.**

3.4.1 At any time, but subject to vacancies occurring and not yet filled, 1/3 of the directors shall be nominees of the Investment Dealers Association of Canada (the "IDA"), 1/3 shall be nominees of the Investment Funds Institute of Canada ("IFIC") (1 of which IFIC nominees shall be a director, officer or employee of a mutual fund distributor which is not a member, or an associate or an affiliate of a member, of IFIC) and 1/3 shall be and remain during their term of office persons who are not directors, partners, officers, salespersons or employees of a Member, or of an associate, affiliate or related company of a Member, or of the Corporation, the IDA or IFIC, or of a member, or an associate or an affiliate of a member, of the IDA or IFIC ("public directors").

3.4.2 The directors in office at the date of enactment of this provision are hereby confirmed as directors of the Corporation and shall hold office until their successors are elected or appointed in accordance with the provisions of this By-law.

3.5 **Appointment, Election and Term**.

3.5.1 ***Nominees of the IDA and IFIC:*** Nominees of the IDA and IFIC shall serve as directors until they cease to be directors in accordance with Section 3.6 or until they are replaced by their respective nominators by notice given to the Chair of the Corporation in accordance with Section 3.7, whichever occurs first.

3.5.2 ***Public directors:***

(a) At such time following the first annual meeting after the date on which the Corporation is recognized as a self-regulatory organization under any applicable securities legislation, the directors then in office shall elect seven public directors, who have been selected in accordance with Section 3.10 and who may but need not be the public directors in office at such time. Of the seven public directors so elected, three shall serve until their successors are elected at the first directors' meeting following the next annual meeting and four shall serve until their successors are elected at the first directors' meeting following the next succeeding annual meeting. The names of the three public directors who shall serve for one-year terms shall be chosen by lot at the time of such election.

(b) Thereafter at the first directors' meeting following each annual meeting of Members, the directors then in office shall elect three or four public directors, as the case may be, to replace those public directors whose terms have expired.

(c) Subject to the provisions of this By-law, the public directors' term of office shall be from the time at which they are elected until their successors are elected at the first directors' meeting following the second annual meeting of Members held after their election or until they are removed or replaced in accordance with the provisions of this By-law, whichever occurs first. Subject to the provisions of Section 3.7.2, each public director shall be eligible (if otherwise qualified) for re-election for a maximum of two further consecutive terms; provided that a public director who ceases to be a member of the Board of Directors for at least two years shall thereafter be eligible (if otherwise qualified) for election and re-election for a maximum of three further consecutive terms.

3.6 **Vacancies**. The office of a director shall automatically be vacated:

3.6.1 in the case of a director who has been nominated by the IDA or IFIC, if a written notice is received by the Corporation that the IDA or IFIC, as the case may be, has revoked such director's nomination;

3.6.2 in the case of a public director, if the director ceases to be qualified as a public director under Section 3.4 or if at a meeting of the Board of Directors, a resolution is passed by at least 3/4 of the votes cast by the members of the Board removing such public director;

3.6.3 if the director becomes bankrupt or suspends payment of debts generally or compounds with creditors or makes an authorized assignment or is declared insolvent;

3.6.4 if the director is found to be a mentally incompetent person or becomes of unsound mind;

3.6.5 if the director by notice in writing to the Corporation resigns office which resignation shall be effective at the time it is received by the Secretary of the Corporation or at the time specified in the notice, whichever is later; or

3.6.6 if the director dies.

3.7 **Filling Vacancies**. If a director (the "previous director") ceases to be a director for any reason, the vacancy so created shall be filled by a nominee of the nominator who nominated the previous director or, in the case of a public director, by a person elected by the remaining directors.

3.7.1 ***IDA or IFIC nominee:*** In the case of a nominee of the IDA or IFIC, notice of the nomination shall be in writing, signed by an authorized signing officer of the nominator and delivered to the Chair of the Corporation as soon as reasonably possible. The notice may fix a date on which the nominee's appointment shall take effect but, if the notice does not fix such a date, the nominee's appointment to the Board of Directors shall take effect on the date on which the Chair receives the notice. If a nominee of the IDA or of IFIC, as the case may be, is not appointed to fill a vacancy in accordance with the foregoing within 60 days of the previous director ceasing to be a director, a director nominated by whichever organization then has the greater number of nominees on the Board of Directors (including for this purpose, as if he or she were a director nominated by IFIC, the director who is a director, officer or employee of a mutual fund dealer which is not a Member of IFIC) shall cease to be a director upon the expiration of such 60-day period, the intention being that at the end of such 60-day period each of the IDA and IFIC shall have equal representation on the Board of Directors. The director who shall cease to be a director in these circumstances shall be determined by alphabetical order (i.e., by the first letter of such director's surname).

3.7.2 ***Public director:*** In the case of a person elected to fill a vacancy among the public directors prior to the expiry of the previous director's term, the person shall serve for the balance of such term and shall thereupon be eligible, if otherwise qualified, to serve three further consecutive terms.

3.8 **Executive Committee**. The Board of Directors may establish an executive committee composed of such directors as the Board may from time to time determine provided that there shall be equal representation by nominees of the IDA and IFIC and by public directors. The executive committee shall exercise such powers as are authorized by the Board of Directors including, without limitation, the authority to exercise any powers of the Board of Directors. Subject to the By-laws and any resolution of the Board of Directors, meetings of the executive committee shall be held at any time and place to be determined by the members of the executive committee provided that 48 hours' written notice of such meeting shall be given, other than by mail, to each member of the executive committee. Notice by mail shall be sent at least 14 days prior to the meeting. A majority of the members of the executive committee shall constitute a quorum. No error or accidental omission in giving notice of any meeting of the executive committee shall invalidate such meeting or make void any proceedings taken at such meeting. Any executive committee member may be removed by resolution of the Board of Directors.

3.9 **Audit Committee**. The Board of Directors shall establish an audit committee composed of such directors as the Board of Directors may from time to time determine provided that there shall be equal representation by nominees of the IDA and IFIC and by public directors. The audit committee shall review and report to the Board of Directors on the annual financial statements of the Corporation prior to their approval by the Board of Directors and shall perform such other duties and activities as may from time to time be authorized by the Board of Directors. Subject to the By-laws and any resolution of the Board of Directors, meetings of the audit committee shall be held at any time and place to be determined by the members of the audit committee provided that 48 hours' written notice of such meeting shall be given, other than by mail, to each member of the audit committee. Notice by mail shall be sent at least 14 days prior to the meeting. A majority of the members of the audit committee shall constitute a quorum. No error or accidental omission in giving notice of any meeting of the audit committee shall invalidate such meeting or make void any proceedings taken at such meeting. Any audit committee member may be removed by resolution of the Board of Directors.

3.10 **Governance Committee**. The Board of Directors shall establish a Governance Committee composed of such directors as the Board of Directors may from time to time determine provided that there shall be equal representation by nominees of the IDA and IFIC and by public directors. The Governance Committee shall select and review individuals to be put forth to the Board of Directors for consideration and election as public directors under Section 3.5.2. Subject to the By-laws and any resolution of the Board of Directors, meetings of the Governance Committee shall be held at any time and place to be determined by the members of the Governance Committee provided that 48 hours' written notice of such meeting shall be given, other than by mail, to each member of the Governance Committee. Notice by mail shall be sent at least 14 days prior to the meeting. A majority of the members of the Governance Committee shall constitute a quorum. No error or accidental omission in giving notice of any meeting of the Governance Committee shall invalidate such meeting or

make void any proceedings taken at such meeting. Any Governance Committee member may be removed by resolution of the Board of Directors.

3.11 **Other Committees**. The Board of Directors may from time to time appoint any other committee or committees as it deems necessary or appropriate for such purposes and with such powers as the Board shall see fit including, without limitation, the authority to exercise any powers of the Board of Directors. Any committee so appointed shall have equal representation by nominees of the IDA and IFIC and by public directors. Any such committee may formulate its own rules of procedure, subject to such regulations or directions as the Board may from time to time make. Any committee member may be removed by resolution of the Board of Directors. The Board of Directors may fix any remuneration for committee members who are not also directors of the Corporation.

3.12 **Remuneration of Directors**. Except for public directors, who may receive such reasonable remuneration, if any, as may be determined by the Board from time to time, the directors shall serve as such without remuneration and shall not directly or indirectly receive any profit from occupying the position of director; provided that any director may be reimbursed for reasonable expenses incurred by the director in the performance of the director's duties. Subject to Section 6, nothing herein contained shall be construed to preclude any director from serving the Corporation as an officer or in any other capacity and receiving compensation therefor.

4. **Meetings of Directors.**

4.1 **Place of Meeting**. Meetings of the Board of Directors may be held at any place within or outside Canada.

4.2 **Notice**. A meeting of directors may be convened by the Chair of the Board, the Vice-Chair of the Board, the President and Chief Executive Officer or any two directors at any time. The Secretary, when directed or authorized by any of such officers or any two directors, shall convene a meeting of directors. Unless sent by mail, seven days notice of such meeting shall be given to each director. Notice of any such meeting that is sent by mail shall be served in the manner specified in Section 32 not less than 14 days (exclusive of the day on which the notice is given) before the meeting is to take place; provided always that a director may in any manner and at any time waive notice of a meeting of directors and attendance of a director at a meeting of directors shall constitute a waiver of notice of the meeting except where a director attends a meeting for the express purpose of objecting to the transaction of any business on the grounds that the meeting is not lawfully called; provided further that meetings of directors may be held at any time without notice if all the directors are present (except where a director attends a meeting for the express purpose of objecting to the transaction of any business on the grounds that the meeting is not lawfully called) or if all of the absent directors waive notice before or after the date of such meeting.

4.3 **Error or Omission in Giving Notice**. No error or accidental omission in giving notice of any meeting of directors shall invalidate such meeting or make void any proceedings taken at such meeting.

4.4 **Chair and Secretary**. The Chair of the Board or, in his or her absence, the Vice-Chair, shall be chair of any meeting of the directors. If no such officer is present, the directors present shall choose one of their number to be chair. If the Secretary is absent, the chair of the meeting shall appoint some person, who need not be a director, to act as secretary of the meeting.

4.5 **Adjournment**. Any meeting of directors may be adjourned from time to time by the Chair of the meeting, with the consent of the meeting, to a fixed time and place. Notice of any adjourned meeting of directors is not required to be given if the time and place of the adjourned meeting is announced at the original meeting. Any adjourned meeting shall be duly constituted if held in accordance with the terms of the adjournment and a quorum is present thereat. The directors who formed a quorum at the original meeting are not required to form the quorum at the adjourned meeting. If there is no quorum present at the adjourned meeting, the original meeting shall be deemed to have terminated forthwith after its adjournment. Any business may be brought before or dealt with at any adjourned meeting which might have been brought before or dealt with at the original meeting in accordance with the notice calling the same.

4.6 **Regular Meetings**. The Board of Directors may appoint a day or days in any month or months for regular meetings of the Board of Directors at a place or hour to be named by the Board of Directors and a copy of any resolution of the Board of Directors fixing the place and time of regular meetings of the Board of Directors shall be sent to each director forthwith after being passed, but no other notice shall be required for any such regular meetings.

4.7 **Quorum**. A majority of the directors then in office shall form a quorum for the transaction of business and, notwithstanding any vacancy among the directors, a quorum of directors may exercise all the powers of directors.

4.8 **Voting**. Each director is authorized to exercise 1 vote. Questions arising at any meeting of directors shall be decided by a majority of votes. In case of an equality of votes the Chair of the meeting in addition to an original vote shall not have a second or casting vote.

4.9 **Telephone Participation**. If all the directors of the Corporation consent in advance, any meeting of directors may be held by means of such telephone, electronic or other communication facilities as permit all persons participating in the meeting to hear each other simultaneously and instantaneously, and a director participating in such meeting by such means is deemed to be present at that meeting. The directors shall take such reasonable precautions as may be necessary to ensure that such telephone, electronic or other communications facilities are secure from unauthorized interception or monitoring. For purposes of determining those present and recording votes at such a meeting the chair of the meeting shall require each director participating by such means to identify himself or herself and

to acknowledge by voice such director's presence or vote, as the case may be, and the chair of the meeting and the Corporation shall be entitled to rely thereon in the absence of evidence to the contrary.

4.10 **Resolution in Lieu of Meeting**. If permitted by law, a resolution in writing, signed by all the directors entitled to vote on that resolution at a meeting of directors or committee of directors, is as valid as if it had been passed at a meeting of directors or committee of directors.

5. **Powers of Directors.**

5.1 **Administer Affairs**. The Board of Directors shall administer the affairs of the Corporation in all things and make or cause to be made for the Corporation, in its name, any kind of contract which the Corporation may lawfully enter into and, save as hereinafter provided, generally, shall exercise all such other powers and do all such other acts and things as the Corporation is by its Letters Patent or otherwise authorized to exercise and do.

5.2 **Expenditures**. The Board of Directors shall have power to authorize expenditures on behalf of the Corporation from time to time and to delegate by resolution such power to an officer or officers of the Corporation.

5.3 **Borrowing Power**. The Board of Directors may from time to time:

5.3.1 borrow money on the credit of the Corporation;

5.3.2 limit or increase the amount to be borrowed;

5.3.3 issue, sell or pledge debt obligations (including bonds, debentures, debenture stock, notes or other like liabilities whether secured or unsecured) of the Corporation;

5.3.4 charge, mortgage, hypothecate or pledge all or any currently owned or subsequently acquired real or personal, movable or immovable property of the Corporation, including book debts, rights, powers and undertakings, to secure any debt obligations or any money borrowed, or other debt or liability of the Corporation; and

5.3.5 delegate the powers conferred on the directors under this Section to such officer or officers of the Corporation and to such extent and in such manner as the directors shall determine.

The powers hereby conferred shall be deemed to be in supplement of and not in substitution for any powers to borrow money for the purposes of the Corporation possessed by its directors or officers independently of this By-law.

5.4 **Agents and Employees**. The Board of Directors may appoint such agents and engage such employees as it shall deem necessary from time to time and such persons shall have such authority and shall perform such duties as shall be prescribed by the Board of Directors at the time of such appointment.

6. **Interested Director Contracts.**

6.1 **Conflict of Interest**. A director who is in any way directly or indirectly interested in a contract or proposed contract with the Corporation shall make the disclosure required by the Act and except as provided by the Act, no such director shall vote on any resolution to approve any such contract. In supplement of and not by way of limitation upon any rights conferred upon directors by Section 98 of the Act and specifically subject to the provisions contained in that Section, it is declared that no director shall be disqualified from any such office by, or vacate any such office by reason of, holding any office with the Corporation or with any corporation in which the Corporation shall be a shareholder or by reason of being otherwise in any way directly or indirectly interested or contracting with the Corporation as vendor, purchaser or otherwise or being concerned in any contract or arrangement made or proposed to be entered into with the Corporation in which the director is in any way directly or indirectly interested as vendor, purchaser or otherwise. Subject to compliance with the Act, no contract or arrangement entered into by or on behalf of the Corporation in which any director shall be in any way directly or indirectly interested shall be void or voidable and no director shall be liable to account to the Corporation or any of its Members or creditors for any profit realized by or from any such contract or arrangement by reason of any fiduciary relationship.

6.2 **Submission of Contracts or Transactions to Members for Approval**. The Board of Directors in its discretion may submit any contract, act or transaction with the Corporation for approval or ratification at any annual meeting of the Members or at any general or special meeting of the Members called for the purpose of considering the same and, subject to the provisions of Section 98 of the Act, any such contract, act or transaction that shall be approved or ratified or confirmed by a resolution passed by a majority of the votes cast at any such meeting (unless any different or additional requirement is imposed by the Act, the Letters Patent or the By-laws) shall be as valid and as binding upon the Corporation and upon all the Members as though it had been approved, ratified or confirmed by every Member of the Corporation.

6.3 **Interest Respecting the IDA or IFIC.** For the purposes of Sections 6.1 and 6.2, the Act, the Letters Patent, this By-law or any other principle of law, the fact that a director is a director, officer or employee of any of the IDA, IFIC, or of a member of either of them or of the Corporation or of a mutual fund distributor which is not a member of IFIC, shall not be considered to constitute a conflict of interest or a basis for requiring a contract, act or transaction involving the Corporation to be submitted to the Members or disclosed as required by the Act, this By-law or at law.

7. **Officers.**

7.1 **Appointment**. The Board of Directors shall annually or more often as may be required, appoint a Chair of the Board (who shall be the Chairperson of IFIC unless the organization with which he or she is affiliated does not have as a core business the retail distribution of mutual funds, in which event the Chair shall be the Chair of the Retail Distributor Council of Governors of IFIC), and a President

and Chief Executive Officer (who shall be the President of the IDA), and may, as often as may be required, appoint a Vice Chair of the Board, a Chief Operating Officer, one or more Vice-Presidents, a Secretary, a Treasurer and one or more Assistant Secretaries and/or one or more Assistant Treasurers. No person shall serve as Chair of the Board for more than a one year term. For purposes of this Section 7.1, the term of office of a person who is appointed to fill a vacancy as Chair of the Board shall not include the remainder of the term during which such vacancy occurred. If the foregoing provisions would otherwise result in the Chair of the Board being reappointed to a consecutive term as Chair, the Chair of the Retail Distributor Council of Governors of IFIC shall be appointed Chair of the Board. A director may be appointed to any office of the Corporation but none of the said officers need be a director or Member of the Corporation except that the Chair of the Board, the Vice-Chair of the Board and the President and Chief Executive Officer shall be directors of the Corporation. Two or more of the aforesaid offices may be held by the same person. In case and whenever the same person holds the offices of Secretary and Treasurer that person may but need not be known as the Secretary-Treasurer. The Board of Directors may from time to time appoint such other officers and agents as it shall deem necessary who shall have such authority and shall perform such duties as may from time to time be prescribed by the Board of Directors.

7.2 **Vacancies**. Notwithstanding the foregoing, each incumbent officer shall continue in office until the earlier of:

7.2.1 that officer's resignation, which resignation shall be effective at the time the written resignation is received by the Secretary of the Corporation or at the time specified in the resignation, whichever is later;

7.2.2 the appointment of a successor;

7.2.3 that officer ceasing to be a director if such is a necessary qualification of appointment;

7.2.4 the meeting at which the directors annually appoint the officers of the Corporation;

7.2.5 that officer's removal;

7.2.6 that officer's death.

If the office of any officer of the Corporation shall be or become vacant, the directors may, by resolution, appoint a person to fill such vacancy.

7.3 **Remuneration of Officers**. The remuneration of all officers appointed by the Board of Directors shall be determined from time to time by resolution of the Board of Directors or by any officer authorized by the Board of Directors. All officers shall be entitled to be reimbursed for reasonable expenses incurred in the performance of the officer's duties.

7.4 **Removal and Reappointment of Officers**. Officers shall be subject to removal by resolution of the Board of Directors at any time, with or without cause. If the Chair of the Board is removed by resolution of the Board of Directors, a nominee of IFIC shall be appointed by the directors as Chair of the Board until a new Chairperson of IFIC is appointed, whereupon the new Chairperson of IFIC shall become the Chair of the Board unless the organization with which he or she is affiliated does not have as a core business the retail distribution of mutual funds, in which event the Chair shall be the Chair of the Retail Distributor Council of Governors of IFIC. If the President and Chief Executive Officer is removed by resolution of the Board of Directors, the directors shall appoint a nominee of IDA, other than the President of IDA, to serve as President and Chief Executive Officer for the remainder of the then-current term of office and annually thereafter until the President of IDA is replaced, whereupon the new President of IDA shall become the President and Chief Executive Officer of the Corporation.

7.5 **Duties of Officers May be Delegated**. In case of the absence or inability to act of any officer of the Corporation or for any other reason that the Board of Directors may deem sufficient, the Board of Directors may delegate all or any of the powers of any such officer to any other officer or to any director for the time being.

7.6 **Powers and Duties**. All officers shall sign such contracts, documents or instruments in writing as require their respective signatures and shall respectively have and perform all powers and duties incidental to their respective offices and such other powers and duties respectively as may from time to time be assigned to them by the Board of Directors. The duties of the officers shall include:

7.6.1 *Chair of the Board*. If appointed, the Chair shall, subject to the provisions of the Act, preside at all meetings of the Board of Directors and the Members.

7.6.2 *Vice-Chair of the Board*. If the Chair of the Board is absent or is unable or refuses to act, the Vice-Chair of the Board, if any, shall, when present, preside at all meetings of the Board of Directors and the Members.

7.6.3 *President and Chief Executive Officer*. The President and Chief Executive Officer shall be the chief executive officer of the Corporation and, subject to the authority of the Board of Directors shall have general supervision of the business of the Corporation and shall have such other powers and duties as the Board may specify.

7.6.4 *Chief Operating Officer*. The Chief Operating Officer shall be the chief operating officer of the Corporation, shall report to the President and Chief Executive Officer and, under the President and Chief Executive Officer's direction, manage the staff of the Corporation and carry out such administrative functions as are required for the operations of the Corporation. In addition, where required by any agreement or arrangement made between the Corporation and the IDA, the Chief Operating Officer shall report directly to the Board of Directors or the Executive Committee.

7.6.5 *Vice-President*. A vice-president shall have such powers and duties as the Board or the President and Chief Executive Officer may specify.

7.6.6 *Secretary*. The Secretary, as and when requested to do so, shall: attend and be the secretary of all meetings of the Board of Directors, Members and

committees of the Board of Directors and enter or cause to be entered in records kept for that purpose minutes of all proceedings thereat; give or cause to be given, as and when instructed, all notices to Members, directors, officers, auditors and Members of committees of the Board of Directors; be the custodian of the stamp or mechanical device generally used for affixing the corporate seal of the Corporation (if any) and of all books, papers, records, documents and instruments belonging to the Corporation, except when some other officer or agent has been appointed for that purpose; and have such other powers and duties as the Board of Directors or the chief executive officer may specify.

7.6.7 *Controller*. The controller shall keep proper accounting records in compliance with the Act and shall be responsible for the deposit of money, the safekeeping of securities and the disbursement of the funds of the Corporation; the controller shall render to the Board whenever required an account of all his or her transactions as controller and of the financial position of the Corporation; and the controller shall have such other powers and duties as the Board or the chief executive officer may specify.

7.6.8 *Powers and Duties of Other Officers*. The powers and duties of all other officers shall be such as the terms of their engagement call for or as the Board or the chief executive officer may specify. Any of the powers and duties of an officer to whom an assistant has been appointed may be exercised and performed by such assistant, unless the Board or the chief executive officer otherwise directs.

8. **For the Protection of Directors and Officers.**

8.1 **Limitation of Liability**. No director, officer, employee or agent shall be liable for the acts, receipts, neglects or defaults of any other director, officer, employee or agent, or for joining in any receipt or other act for conformity, or for any loss, damage or expense happening to the Corporation through the insufficiency or deficiency of title to any property acquired for or on behalf of the Corporation, or for the insufficiency or deficiency of any security in or upon which any of the moneys of the Corporation shall be invested, or for any loss or damage arising from the bankruptcy, insolvency or tortious acts of any person with whom any of the moneys, securities or effects of the Corporation shall be deposited, or for any loss occasioned by any error of judgment or oversight on his or her part, or for any other loss, damage or misfortune whatever which shall happen in the execution of the duties of his or her office or in relation thereto; provided that nothing herein shall relieve any director or officer from the duty to act in accordance with the Act and the regulations thereunder or from liability for any breach thereof.

8.2 **Indemnity**. Every director or officer of the Corporation, or other person who has undertaken or is about to undertake any liability on behalf of the Corporation or any company controlled by it, and their heirs, executors and administrators, and estate and effects, respectively, shall from time to time and at all times, be indemnified and saved harmless out of the funds of the Corporation, from and against:

8.2.1 all costs, charges and expenses which such director, officer or other person sustains or incurs in or about any action, suit or proceeding which is brought, commenced or prosecuted against him or her, or in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him or her, in or about the execution of the duties of his or her office or in respect of any such liability; and

8.2.2 all other costs, charges and expenses which he or she sustains or incurs in or about or in relation to the affairs thereof, except such costs, charges or expenses as are occasioned by his or her own wilful neglect or default.

The Corporation shall also indemnify such persons in such other circumstances as the Act permits or requires. Nothing in this By-law shall limit the right of any person entitled to indemnity apart from the provisions of this By-law.

8.3 **Insurance**. The Corporation may purchase and maintain insurance for the benefit of any person referred to in Section 8.2 against such liabilities and in such amounts as the Board may from time to time determine and are permitted by the Act.

MEMBERSHIP

9. **Eligibility.**

9.1 **Discretion of the Board of Directors.** The Board of Directors shall, in its discretion, decide upon all applications for Membership.

9.2 **Requirements.** Any individual, firm or corporation shall be eligible to apply for Membership if:

9.2.1 in the case of an individual, the applicant is a resident of Canada; in the case of a firm, it is a resident of Canada and, in the case of a corporation, it is incorporated under the laws of Canada or one of its provinces or territories;

9.2.2 the applicant carries on, or proposes to carry on, business in Canada as a mutual fund dealer and is registered or licensed in each jurisdiction in Canada where the nature of its business requires such registration or licensing, and is in compliance with such securities legislation and the requirements of any securities commission having jurisdiction over the applicant; and

9.2.3 the applicant and its directors, officers, partners, employees and agents, and related companies (if any), would comply with, or would otherwise be subject to a regulatory regime with rules, by-laws or policies similar in effect to, the By-laws, Rules, Policies and Forms of the Corporation that would apply to them if the applicant were a Member.

9.3 **Amalgamation of Members.** If two or more Members propose to amalgamate and continue as one Member, the continuing Member shall not be considered to be a new Member or be required to re-apply for Membership, except as otherwise determined by the Board of Directors and provided that the continuing Member

otherwise complies with the By-laws and Rules including the payment of Member fees.

10. **Application.**

10.1 **Form.**

10.1.1 An application for Membership shall be in such form and executed in such manner as the Board of Directors may prescribe and shall contain or be accompanied by such information and documents as the By-laws or the Board of Directors may require.

10.1.2 The prescribed Form shall be signed by the applicant.

10.2 **Review Deposit.** An application for Membership shall be accompanied by a refundable application review deposit in an amount to be determined by the Board of Directors, to be credited towards the Annual Fee in the event that the application is approved by the Board of Directors.

10.3 **Reimbursement for Excessive Costs and Expenses.** If in connection with the review or consideration of any application for Membership, the Board of Directors is of the opinion that the nature of the applicant's business, its financial condition, the conduct of its business, the completeness of the application, the basis on which the application was made or any Corporation review in respect of the application in accordance with the By-laws of the Corporation has required, or can reasonably be expected to require, excessive attention, time and resources of the Corporation, the Board of Directors may require the applicant to reimburse the Corporation for some or all of its costs and expenses which are reasonably attributable to such excessive attention, time and resources or provide an undertaking or security in respect of such reimbursement. If an applicant is to be required to make such reimbursement of costs and expenses, the Corporation shall provide to the applicant a breakdown and explanation of such costs and expenses in sufficient detail to permit the applicant to understand the basis on which the costs and expenses were or are to be calculated.

11. **Approval Process.**

11.1 **Preliminary Review by the Corporation.** An application for Membership with any accompanying documents shall be submitted to the Corporation, which shall make a preliminary review of the same and either:

11.1.1 if such review discloses substantial compliance with the requirements of the By-laws and Rules, transmit a copy to the Chair of the Board or a director or committee of directors authorized for that purpose; or

11.1.2 if such review discloses any substantial non-compliance with the requirements of the By-laws and Rules, notify the applicant as to the nature of such non-compliance and request that the application for Membership be amended in accordance with the notification of the Corporation and refiled or be withdrawn. If the applicant declines to amend or withdraw the application for Membership, the Corporation shall forward the same to the Chair of the Board or a director or committee of directors authorized for that purpose, together with any accompanying material and a copy of the notification to the applicant.

11.2 **Submission of Financial Information.** The application shall be accompanied by:

11.2.1 financial statements of the applicant as of a date not more than 90 days prior to the date of application for Membership (or as of such other date as the Corporation may require), prepared in accordance with Form 1 and audited by an auditor acceptable to the Corporation;

11.2.2 interim unaudited monthly financial statements, prepared in accordance with Form 1, for the period following the date of the audited financial statement submitted under Section 11.2.1 up to the most recent month prior to the date of the Membership application;

11.2.3 a report by the applicant's auditor to the effect that, based on his examination of the affairs of the applicant, the applicant keeps a proper system of books and records; and

11.2.4 such additional financial information, if any, relating to the applicant as the Corporation may in its discretion request.

11.3 **Notification to the Board of Directors.** If and when the Corporation has received the financial statements and report referred to in Section 11.2, and is satisfied with respect to all relevant matters, then the Corporation shall so notify the Board of Directors.

11.4 **Determination of the Board of Directors.** Upon receipt of the application for Membership from the Corporation and the notification from the Corporation pursuant to Section 11.3, the Board of Directors may:

11.4.1 at the expiration of a period of six months or such lesser period as the Board of Directors may in any particular case determine, approve the application;

11.4.2 approve the application subject to such terms and conditions as may be considered appropriate by the Board of Directors if, in the opinion of the Board of Directors, such terms and conditions are necessary in order to ensure that the By-laws and Rules will be complied with by the applicant; or

11.4.3 refuse the application if, in the opinion of the Board of Directors, having regard to such factors as it may consider relevant including, without limitation, the past or present conduct, business or condition of the applicant;

(a) it is not satisfied that the By-laws and Rules will be complied with by the applicant;

(b) the applicant is not qualified by reason of the ownership, integrity, solvency, training or experience of the applicant or any of its partners, directors, officers, employees or agents, or any person

having an ownership interest in the capital or indebtedness of the applicant; or

(c) such approval is not in the public interest.

11.5 **Right to be Heard.** If the Board of Directors proposes to approve an application subject to terms and conditions pursuant to Section 11.4.2 or to refuse an application pursuant to Section 11.4.3:

11.5.1 the applicant shall be provided with a statement of the grounds upon which the Board of Directors proposes to approve the application subject to terms and conditions or to refuse the application, and the particulars of those grounds;

11.5.2 the applicant shall be provided with a summary of the facts and evidence which are to be considered by the Board of Directors;

11.5.3 the Board of Directors shall permit the applicant to appear before it on reasonable notice, and with counsel or other representative, to call evidence and cross-examine witnesses in order to show cause why the application should not be subject to terms and conditions or should not be refused.

11.6 **Hearing.**

11.6.1 A hearing held pursuant to Section 11.5 shall be open to the public except where the Board of Directors determines that all or any part of the hearing should be held in camera in accordance with the principles set out in Section 25. To the extent not otherwise specified in this Section 11, the procedures applicable to proceedings under Section 25 shall be applicable to a hearing under this Section 11, mutatis mutandis.

11.6.2 If within 14 days of being notified of a proposal to approve an application subject to terms and conditions or to refuse an application, the applicant fails to request a hearing, the Board of Directors may approve the application subject to the proposed terms and conditions or refuse the application. If the applicant requests a hearing, the Board of Directors may, after permitting the parties to be heard, exercise any of its powers in accordance with Section 11.4.

11.6.3 No member of the Board of Directors who has participated in a decision to propose the imposition of terms and conditions on an applicant or the refusal of an application shall subsequently participate in a hearing pursuant to Section 11.7 regarding that application.

11.6.4 Any decision of the Board of Directors at a hearing held pursuant to Section 11.5 shall be in writing and shall contain a concise statement of the reasons for the decision. Notice of a decision shall be delivered to the Corporation which shall then promptly give notice to the applicant. A copy of the decision shall accompany the notice.

11.7 **Power to Vary or Remove Terms and Conditions.**

11.7.1 The Board of Directors shall have the power to vary or remove any such terms and conditions as may have been imposed on an applicant that may be considered appropriate by the Board of Directors, if such terms and conditions are or are no longer, as the case may be, necessary to ensure that the By-laws and Rules will be complied with by the applicant. In the event that the Board of Directors proposes to vary terms and conditions in a manner which would be more burdensome to the applicant, the provisions of Sections 11.5 and 11.6, inclusive, shall apply in the same manner as if the Board of Directors was exercising its powers thereunder in regard to the applicant.

11.7.2 If, pursuant to the provisions of Section 11.4, the Board of Directors approves an application subject to terms and conditions or refuses an application, the Board of Directors may order that the applicant may not apply for removal or variation of terms and conditions or reapply for approval, for such period as the Board of Directors provides.

11.8 **Actions Upon Approval of Application.**

11.8.1 If and when the application is approved by the Board of Directors, the Corporation shall compute the amount of the Annual Fee to be paid by the applicant pursuant to Section 14.

11.8.2 Subject to the provisions of Section 10.3, the Corporation shall advise at the next meeting of the Board of Directors the amount of the Annual Fee to be paid by the applicant, less the amount of the deposit submitted by the applicant pursuant to Section 10.2

11.8.3 If and when the application has been approved by the Board of Directors, and the applicant has been duly licensed or registered to carry on business as a mutual fund dealer under the applicable law of the province or provinces or territories in which the applicant carries on or proposes to carry on business, and upon payment of the balance of the Annual Fee, the applicant shall become and be a Member.

11.8.4 Notwithstanding the foregoing, if an applicant qualifies for exemption from payment of the Annual Fee and if the Board of Directors approves of such exemption and gives its approval to the application for Membership, the applicant shall be admitted to Membership if all other conditions relating to an application for Membership have been duly complied with except such conditions, if any, as the Board of Directors may deem appropriate to be waived under the circumstances of any particular case.

11.8.5 The Corporation shall keep a register of the names and business addresses of all Members and of their respective Annual Fees. The Annual Fees of Members shall not be made public by the Corporation.

12. **Members' Meetings.**

12.1 **Time and Place of Meetings.** Subject to compliance with Section 102 of the Act, the Annual Meeting shall be held on such day in each year and at such time as the directors may determine at any place within Canada or, if a majority of the Members so agree, outside Canada.

12.2 **Annual Meetings**. At every Annual Meeting, in addition to any other business that may be transacted, the names and nominators of the directors of the Corporation, the report of the directors, the financial statements and the report of the auditors shall be presented to the Members and auditors appointed for the ensuing year. The Members may consider and transact any business, either special or general, at any meeting of Members.

12.3 **Special Meetings**. Other meetings of the Members may be convened by order of the Chair of the Board, the Vice-Chair of the Board, the President and Chief Executive Officer, if a director, or by the Board of Directors at any date and time and at any place within Canada or, if a majority of the Members so agree, outside Canada. The Board of Directors shall call a special general meeting of Members on written requisition of Members carrying not less than 20% of the voting rights.

12.4 **Notice**. 14 days' written notice shall be given in the manner specified in Section 32.1 to each voting Member of any annual or special general meeting of Members. Notice of any meeting where special business will be transacted should contain sufficient information to permit the Member to form a reasoned judgment on the decision to be taken. Notice of each meeting of Members must remind the Member that the Member has the right to vote by proxy.

12.5 **Error or Omission in Giving Notice**. No error or omission in giving notice of any annual or special meeting or any adjourned meeting of the Members of the Corporation shall invalidate any resolution passed or any proceedings taken at any meeting of Members.

12.6 **Chair, Secretary and Scrutineers**. The Chair of the Board or, in his or her absence, the Vice-Chair of the Board shall be the chair of any meeting of Members. If no such officer is present within 15 minutes from the time fixed for holding the meeting, the Members present and entitled to vote shall choose one of their number to be the chair of the meeting. If the Secretary is absent, the chair of the meeting shall appoint some person, who need not be a Member, to act as secretary of the meeting. If desired, one or more scrutineers, who need not be Members, may be appointed by the chair of the meeting with the consent of the meeting.

12.7 **Quorum**. A quorum at any meeting of the Members (unless a greater number of Members and/or proxies are required to be present by the Act or by the Letters Patent or any other By-law) shall be persons present being 10 in number and being or representing by proxy 10% of the Members entitled to vote at such meeting. No business shall be transacted at any meeting unless the requisite quorum be present at the time of the transaction of such business. If a quorum is not present at the time appointed for a meeting of Members or within such reasonable time thereafter as the Members present may determine, the persons present and entitled to vote may adjourn the meeting to a fixed time and place but may not transact any other business and notice of the adjourned meeting shall be given to all Members in accordance with the provisions of Section 32. If a meeting of Members is so adjourned, quorum at the adjourned meeting shall consist of 10 persons present in person and being or representing by proxy 10% of the Members entitled to vote at such meeting.

12.8 **Adjournment**. The Chair of any meeting of Members may with the consent of the meeting adjourn the same from time to time to a fixed time and place and no notice of such adjournment need be given to the Members. Any business may be brought before or dealt with at any adjourned meeting which might have been brought before or dealt with at the original meeting in accordance with the notice calling the same.

12.9 **Telephone Participation**. If all the Members consent in advance, any meeting of Members may be held by means of such telephone, electronic or other communication facilities as permit all persons participating in the meeting to hear each other simultaneously and instantaneously, and a Member participating in such meeting by such means is deemed to be present at that meeting. Before calling such meeting to order, the chair of such meeting shall be satisfied that all participants have taken reasonable precautions to ensure that such telephone, electronic or other communications facilities are secure from unauthorized interception or monitoring. For purposes of determining those present and recording votes at such a meeting the chair of the meeting shall require each Member participating by such means to identify the Member and to acknowledge by voice such Member's presence or vote, as the case may be, and the chair of the meeting and the Corporation shall be entitled to rely thereon in the absence of evidence to the contrary.

12.10 **Resolution in Lieu of Meeting**. If permitted by law, a resolution in writing, signed by all the Members entitled to vote on that resolution at a meeting of Members, is as valid as if it had been passed at a meeting of Members.

12.11 **Voting of Members**. Each Member shall have one vote. At all meetings of the Members, every question shall be determined on a show of hands by a majority of votes unless otherwise specifically provided by the Act or by these By-laws. In the case of an equality of votes the Chair of the meeting shall both on a show of hands and at a poll have a second or casting vote in addition to the vote or votes to which the Chair may be otherwise entitled.

No Member shall be entitled in person or by proxy to vote at meetings of Members of the Corporation unless the Member has paid all of its Annual fee, assessments or other fees, if any, then payable by the Member.

At any meeting, unless a poll is demanded, a declaration by the Chair of the meeting that a resolution has been carried or carried unanimously or by a particular majority or lost or not carried by a particular majority shall be conclusive evidence of the fact.

A poll may be demanded either before or after any vote by show of hands by any person entitled to vote at the meeting. If at any meeting a poll is demanded on the election of a Chair or on the question of adjournment it shall be taken forthwith without adjournment. If at any meeting a poll is demanded on any other question, the vote shall be taken by ballot in such manner and either at once, later in the meeting or after adjournment as the Chair of the meeting

directs. The result of a poll shall be deemed to be the resolution of the meeting at which the poll was demanded. A demand for a poll may be withdrawn.

12.12 **Proxies**. Votes at meetings of the Members may be given either personally or by proxy or, in the case of a Member who is a body corporate or association, by an individual authorized by a resolution of the Board of Directors or governing body of the body corporate or association to represent it at meetings of Members of the Corporation. At every meeting at which a Member is entitled to vote, every Member and/or person appointed by proxy to represent one or more Members and/or individual so authorized to represent a Member who is present in person shall have one vote on a show of hands. Upon a poll and subject to the provisions, if any, of the Letters Patent, every Member who is entitled to vote at the meeting and who is present in person or represented by an individual so authorized shall have one vote and every person appointed by proxy shall have one vote for each Member who is entitled to vote at the meeting and who is represented by such proxy holder.

A proxy shall be executed by the Member or the Member's attorney authorized in writing or, if the Member is a body corporate or association, by an officer or attorney thereof duly authorized.

A person appointed by proxy must be a Member.

A proxy may be in the following form:

The undersigned Member of Mutual Fund Dealers Association of Canada / Association canadienne des courtiers de fonds mutuels appoints _____ of _____ or failing the person appointed above, _____ of_____ as the proxy of the undersigned to attend and act at the _____ meeting of the Members of the said Corporation to be held on the _____ day of _____ 20____, and at any adjournment or adjournments thereof in the same manner, to the same extent and with the same power as if the undersigned were present at the said meeting or such adjournment or adjournments thereof.

DATED this _____ day of_____, 20___.

_____
Signature of Member

The Board of Directors may from time to time make regulations regarding the lodging of proxies at some place or places other than the place at which a meeting or adjourned meeting of Members is to be held and for particulars of such proxies to be sent by facsimile or in writing before the meeting or adjourned meeting to the Corporation or any agent of the Corporation for the purpose of receiving such particulars and providing that proxies so lodged may be voted upon as though the proxies themselves were produced at the meeting or adjourned meeting and votes given in accordance with such regulations shall be valid and shall be counted. The Chair of any meeting of Members may, subject to any regulations made as aforesaid, in the Chair's discretion accept facsimile or written communication as to the authority of any person claiming to vote on behalf of and to represent a Member notwithstanding that no proxy conferring such authority has been lodged with the Corporation, and any votes given in accordance with such facsimile or written communication accepted by the Chair of the meeting shall be valid and shall be counted.

13. **Resignations, Reorganizations and Terminations.**

13.1 **Resignations**. A Member wishing to resign shall address a letter of resignation to the Board of Directors in care of the Secretary.

13.2 **Letter of Resignation**. A Member which tenders its resignation shall in its letter of resignation state its reasons for resigning and shall file with the Corporation either:

13.2.1 a balance sheet of the Member reported upon by the Member's auditor without qualification as of such date as the Corporation may require which balance sheet shall indicate that the Member has liquid assets sufficient to meet all its liabilities other than subordinated loans, if any; or

13.2.2 a report from the Member's auditor without qualification that in his opinion the Member has liquid assets sufficient to meet all its liabilities other than subordinated loans, if any;

and a report from the Member's auditor that the Member is in compliance with the By-laws and Rules with respect to the holding of client cash, securities and other property. If the financial information required by Section 13.2.1 or 13.2.2 above is not filed with the letter of resignation the Member shall indicate in the letter of resignation the date by which such financial information shall be filed.

13.3 **Notice of Letter of Resignation**. Notice of such letter of resignation shall forthwith be given by the Corporation to the Board of Directors, the applicable Regional Council, all other Members and the securities commissions of all of the provinces of Canada.

13.4 **Time at Which Resignation Becomes Effective**. Unless the Board of Directors, in its discretion otherwise declares, a resignation shall take effect as of the close of business (5:00 p.m. head office local time) on the date Board of Directors (by its Chair, a Vice-Chair or the President) receives confirmation from the Corporation that, in its opinion, the reports of the Member's auditor pursuant to Section 13.2 are in order and if, to the knowledge of the Corporation after due enquiry, the Member is not indebted to the Corporation and no complaint against the Member or any investigation of the affairs of the Member by the Corporation is pending.

13.5 **Notice that Resignation Effective**. When the resignation of a Member becomes effective the Corporation shall so advise the Member resigning and all other Members, the Board of Directors, the securities commissions of all of the provinces of Canada and such other persons or bodies as the Board of Directors may direct.

13.6 **Payment of Annual Fee**. A Member resigning from the Corporation shall make full payment of its Annual Fee for the financial year in which such Member tenders its resignation. A Member resigning from the Corporation shall not be entitled to a refund of any part of the Annual Fee for the financial year in which its resignation becomes effective.

13.7 **Reorganizations, etc**. Notwithstanding the provisions of this Section 13, if the business or ownership of a Member is proposed to be reorganized or transferred, amalgamated or otherwise combined in whole or in part with another person (including a Member) in a manner which the Member or its business will cease to exist in, or will be substantially changed from, its then current form, or a change of control of the Member may occur, the Member (not less than 30 days prior to the proposed effective date of such event) shall give written notice to the Corporation. Upon receipt of such notice, the Corporation shall review the proposed transaction and may request from the Member, its auditors or any other person involved in the transaction, such information as it or the Board of Directors may require including, without limitation, reports with information similar to that referred to in Section 13.2 (as modified for the relevant circumstances) as well as any other information as the Corporation may consider necessary to determine that the obligations of the Member to its clients can be satisfied and the By-laws and Rules will be complied with by the Member or any continuing, new or reorganized entity, as the case may be.

13.8 **Ceasing to Carry on Business as a Mutual Fund Dealer**. If a Member has ceased to carry on business as a mutual fund dealer or its business has been acquired by a person which is not a Member of the Corporation, the Board of Directors may, unless the Member has voluntarily resigned in accordance with this Section 13, terminate the Membership of the Member after the Member has been given the opportunity to be heard in accordance with the provisions of Section 25. A former Member whose Membership has been terminated pursuant to the provisions of this Section 13.8 shall cease to be entitled to exercise any of the rights and privileges of Membership but shall remain liable to the Corporation for all amounts due to the Corporation from the former Member.

13.9 **Ownership**. No Member shall permit an investor, alone or together with its associates and affiliates, to own:

(a) a significant equity interest in the Member; or

(b) special warrants or any other securities that are convertible or exchangeable at any time in the future, into a significant equity interest in the Member;

without the prior approval of the Corporation.

For the purposes of this By-law 13.9, a significant equity interest means the holding of:

(c) voting securities carrying 10 per cent or more of the votes carried by all voting securities of the Member or of a holding company of a Member;

(d) 10 per cent or more of the outstanding participating securities of the Member or of a holding company of a Member; or

(e) an interest of 10 per cent or more of the total equity in the Member.

Notwithstanding the foregoing, the legal representatives of a deceased person who had been approved by the Corporation as the owner of a significant equity interest may continue as registered holder or to hold such interest for such period as the Corporation may permit.

ANNUAL AND OTHER FEES

14. **Annual Fee.**

14.1 **Calculation of Annual Fee.** The Annual Fee for each Member shall be such amount, not less than $3,000 for Members designated as being in Level 1, 2 or 3 under Rule 3.1.1, and not less than $10,000 for Members designated as being in Level 4, determined in accordance with a formula which is based upon the assets under administration of the business of the Member. The Board of Directors in its discretion shall from time to time prescribe such formula and the basis on which the assets under administration of a business are to be determined.

14.2 **Re-determination of Annual Fee.** The Board of Directors may from time to time re-determine the Annual Fee to be payable by any Member. Before any such determination or re-determination is made, the Board of Directors shall obtain, but shall not be obliged to act upon, the recommendation of the Corporation.

14.3 **Timing of Payment.** The Annual Fee shall be paid in quarterly instalments (on the 15th day of July, October, January and April in each year) by each Member beginning not later than the first quarter after admission to Membership of such Member and any additional or redetermined Annual Fee shall be paid in its entirety on or before July 31 in each year.

14.4 **Exemption from Payment.** Notwithstanding the foregoing, in the event that:

14.4.1 an applicant for Membership has acquired the whole or a substantial part of the business and assets of a Member or Members in good standing whose Annual Fee for the then current fiscal year has been paid in full and who is or are resigning from Membership concurrently with the admission of the applicant to Membership; and

14.4.2 at least a majority in number of the partners of the applicant, in the case of a firm, or at least a majority in number of the directors and at least a majority in number of the officers of the applicant, in the case of a corporation, are partners, or directors and officers, as the case may be, of the retiring Member or Members;

then the applicant, if the Board of Directors so approves, shall be exempted from payment of the Annual Fee for the then current fiscal year.

15. **Other Fees.**

15.1 **Power to Make Assessment.** Notwithstanding Section 14, the Board of Directors shall have power to make an assessment in any fiscal year upon each Member on account of:

15.1.1 any extraordinary costs and expenses of the Corporation incurred in connection with the review and/or approval of any reorganization, takeover or other substantial change in the business, structure or affairs of a Member;

15.1.2 fees levied by the Corporation in connection with:

(a) exemption application filings or any other such filing fees which the Board of Directors in its discretion may determine from time to time;

(b) a Member changing its name from that which is shown on the most recent Membership List; or

(c) an application for Membership under Section 10; or

15.1.3 assessments or levies made by or in respect of [MFDA Investor Protection Fund] in accordance with the terms of the agreement and declaration of trust establishing such Fund or any resolution of the Governors of such Fund authorized thereunder.

15.2 **Timing of Payment.** Each Member shall pay the amount so assessed upon it within thirty days after receiving written notification thereof from the Corporation.

16. **Effect of Non-Payment of Fees.**

If the Annual Fee of a Member has not been paid within the time specified in Section 14.3, or the amount assessed upon any Member pursuant to Section 15 has not been paid within the time specified in Section 15.2, the Corporation shall, by registered mail, request the Member to pay the same and draw the Member's attention to the provisions of this Section 16. If the entire amount owing by the Member has not been paid within thirty days from the date the Corporation has mailed the request, the Corporation shall notify the Board of Directors to this effect and the Board of Directors may, in its discretion, terminate the Membership of the Member in default. If the Board of Directors decides to terminate the Membership of a Member pursuant to the provisions of this Section 16, the Corporation will notify the Member, by registered mail, of the decision of the Board of Directors. A former Member whose Membership has been terminated pursuant to the provisions of this Section 16 shall cease to be entitled to exercise any of the rights and privileges of Membership but shall remain liable to the Corporation for all amounts due to the Corporation from the former Member.

REGIONAL COUNCILS

17. **Regions**

17.1 **Designation.** The Board of Directors may from time to time designate any geographic area in Canada as a Region of the Corporation, and may change or terminate any such designation.

17.2 **Regions.** The following geographic areas of Canada have been designated as Regions of the Corporation, until changed or terminated by the Board of Directors:

1. Atlantic (Nova Scotia / New Brunswick / Newfoundland / Prince Edward Island);
2. Ontario;
3. Alberta / Manitoba / Saskatchewan;
4. British Columbia / Territories.

18. **Members of a Region**

18.1 **Members.** The Members of a Region shall be:

18.1.1 Members having their head or principal office in the Region;

18.1.2 Members having one or more branch offices in the Region; and

18.1.3 Members licensed or registered to conduct dealer business by the securities commission having jurisdiction in the Region.

18.2 **Regional Annual Meetings.** A meeting of the Members of each Region shall be called by the Regional Council and held during each calendar year on a date determined by the Regional Council. Notice of the time and place of any such meeting shall be given to the Members of the Region. Seven Members of the Region entitled to vote, present personally or by a partner, director or officer as proxyholder shall be a quorum for any meeting of the Members of the Region.

18.3 **Voting.** Voting at the Regional Annual Meeting of the Members of a Region may be carried out in the same manner as provided for at meetings of Members of the Corporation. Instruments of proxy for such purpose shall be lodged with the Chair of the Regional Council not later than 30 minutes prior to the commencement of the meeting or of any adjournment thereof, and unless so lodged no proxy shall be used or acted upon.

18.4 **Election of Regional Council.** At each Regional Annual Meeting, the Members of each Region shall elect the members of the Regional Council to succeed the members retiring at such Regional Annual Meeting of the Region. The members of such Regional Council shall be elected for a one year term, with the members who have been in office to retire at each Regional Annual Meeting. A retiring member shall be eligible for re-election. In the event of a vacancy on the Regional Council caused by the death, resignation or disability to act of a member thereof, the Regional Council may appoint a person to fill the vacancy for the reminder of the term of such member.

19. **Regional Councils**

19.1 **Establishment and Composition.** There shall be a Regional Council for each Region which, subject to the By-laws, shall represent the Members of such Region. Each Regional Council shall be composed of from 4 to 20 Members, including a Chair and a Vice-Chair but exclusive of ex-officio members, as may be determined at the Regional Annual Meeting of Members called to elect the Council in accordance with Section 18.4. The immediate Past Chair of a Region, the Chair of the Corporation, the President and the Regional Director of the Corporation for the Region in which the Regional Council is located shall be ex-officio Members of such Regional Council entitled to attend and vote at meetings of the Council.

19.2 **Chair and Vice-Chair.** The Regional Council of each Region shall annually, at least four weeks before the Regional Annual Meeting, elect the Chair and the Vice-Chair of the Regional Council for such Region for the succeeding year. No person shall be elected Chair of a Regional Council for more than two terms in succession. In the event of a vacancy in the office of Chair caused by the death, resignation or disability to act of the Chair, the Vice-Chair shall succeed to the office of Chair for the remainder of the term. In the event of a vacancy in the office of Chair as aforesaid at a time when there is no Vice-Chair, the members of the Regional Council may appoint a Chair to fill the vacancy for the remainder of the term. The election of the Chair and the Vice-Chair and members of a Regional Council may be by vote by members of the Regional Council, or in such other manner as the Regional Council may determine.

19.3 **Notice.** At least 15 days before the Regional Annual Meeting for each Region, the Regional Council for each Region shall advise the Secretary in writing of the names of the Chair, the Vice-Chair elected for the ensuing year, and the newly elected Chair, the Vice-Chair and Council shall take office on the date of the annual meeting for the Region next following their election.

19.4 **Default.** In the event that the Regional Council or members of any Region shall in any year fail to elect a Chair, a Vice-Chair and/or members of the Regional Council, the President may at any time before the Regional Annual Meeting of the Region appoint a Chair, a Vice-Chair and/or members to succeed those whose terms will expire at the ensuing Regional Annual Meeting, and the term of office of any Chair, Vice-Chair or members so appointed shall be the same as if he or she and/or they had been elected by the Regional Council or Members of the Region.

19.5 **Term of Office.** The Chair, Vice-Chair and the members of a Regional Council shall hold office until their successors are duly appointed or elected.

19.6 **Public Members.** Each Regional Council shall at its first meeting after the Regional Annual Meeting appoint a roster of individuals (herein called "public members") who shall be eligible only to vote at hearings held by the Regional Council pursuant to Section 25 and shall be eligible for selection as public members to participate in such hearings. Only persons who are legally trained and who are, or have been, qualified as legal practitioners shall be eligible for selection as a public member. No person shall be eligible to be elected or remain a public member if he or she is or becomes during his or her term of office a Member, a partner, director, officer, employee or agent of a Member or associate or affiliate or related company of a Member, an officer, employee or agent of the Corporation, a member of the Regional Council, or any associate thereof. The number of public members appointed to the roster shall be in the discretion of the Regional Council, and individuals may be added to or deleted from such roster from time to time in accordance with the requirements of the Regional Council.

19.7 **Frequency of Meetings.** Each Regional Council shall meet at least once in each calendar year and shall report to the Secretary forthwith after each meeting in respect of any matters brought up at such meeting affecting the interests of the Corporation and shall from time to time report on all matters affecting the interests of the Corporation within its Region. The Secretary shall submit all such reports to the Board of Directors.

19.8 **Telephone, Electronic Meetings.** If all the members of the Regional Council present at or participating in the meeting consent, a meeting of a Regional Council may be held by means of such telephone, electronic or other communication facilities as permit all persons participating in the meeting to communicate with each other simultaneously and a member of a Regional Council participating in such a meeting by such means is deemed to be present at that meeting.

19.9 **Special Meetings.** The Chair or any two members of a Regional Council may call a special meeting of such Council at any time.

19.10 **Proxies.** A voting member of a Regional Council may by written proxy appoint a person to attend and vote as his or her representative at any meeting of such Council. No person shall be entitled to so act as a representative unless he or she is a member of the Regional Council or is a partner, director, officer, employee or agent of a Member of the Region.

19.11 **Quorum.** Three members of a Regional Council present in person shall form a quorum at any meeting thereof and any action taken by a majority of those members of the Council present at any meeting of the Council at which a quorum is present shall constitute the action of the Council.

19.12 **Written Resolutions.** A resolution consented to in writing by 80% of the members of the Regional Council shall be as effective as if passed at a duly constituted meeting of the Regional Council. The consent in writing of a member of the Regional Council may be given by facsimile, e-mail, telex, telegram or other similar electronic means of written communication.

19.13 **Powers of Council.** Unless otherwise provided in the By-laws, a Regional Council shall not act for or in the name of the Corporation and shall not have any power to bind the Corporation except as may be authorized by resolution of the Board of Directors.

19.14 **Remuneration.** Except for public members, who may receive such reasonable remuneration, if any, as may be determined by the Corporation from time to time, the members of the Regional Council shall serve as such without remuneration and shall not, directly or indirectly, receive any profit or remuneration from occupying the position as a member of a Regional Council; provided that any member may be reimbursed for reasonable expenses incurred by such member in the performance of the member's duties.

20. **Committees**

20.1 **Appointment.** The Corporation and a Regional Council for a Region may together appoint such standing committees of the Regional Council to consider and report on such matters related to the regulation of Members in a Region as they may consider appropriate. Any reports or determinations by such committees shall be submitted to the Regional Council and to the Corporation.

20.2 **Duration.** The life of any standing committee or other regional committee shall not extend beyond the term of office of the Regional Council for which it is appointed or authorized.

EXAMINATIONS AND INVESTIGATIONS

21. **Power to Conduct Examinations and Investigations.** The Corporation shall make such examinations of and investigations into the conduct, business or affairs of any Member, Approved Person of a Member or any other person under the jurisdiction of the Corporation pursuant to the By-laws and/or the Rules as it considers necessary or desirable in connection with any matter relating to compliance by such person with:

21.1 the By-laws, Rules or Policies of the Corporation;

21.2 any securities legislation applicable to such person including any rulings, policies, regulations or directives of any securities commission; or

21.3 the by-laws, rules, regulations and policies of any self-regulatory organization.

22. **Basis of Examination or Investigation.** Any examination or investigation made pursuant to Section 21 may be instituted upon the basis of:

22.1 a complaint received by or directed to the Corporation;

22.2 the direction of the Board of Directors;

22.3 the request of a securities commission or self-regulatory organization having jurisdiction; or

22.4 any information received or obtained by the Corporation relating to the conduct, business or affairs of the Member or person involved.

23. **Investigatory Powers.**

23.1 For the purpose of any examination or investigation pursuant to this By-law, a Member, Approved Person of a Member or other person under the jurisdiction of the Corporation pursuant to the By-laws or the Rules may be required by the Corporation:

(a) to submit a report in writing with regard to any matter involved in any such investigation;

(b) to produce for inspection and provide copies of the books, records and accounts of such person relevant to the matters being investigated; and

(c) to attend and give information respecting any such matters;

and the Member or person shall be obliged to submit such report, to permit such inspection, provide such copies and to attend, accordingly. Any Member or person subject to an investigation conducted pursuant to this By-law shall be advised in writing of the matters under investigation and may be invited to make submission by statement in writing, by producing for inspection books, records and accounts and by attending before the persons conducting the investigation. The person conducting the investigation may, in his or her discretion, require that any statement given by any Member or person in the course of an investigation be recorded by means of an electronic recording device or otherwise and may require that any statement be given under oath.

23.2 For the purpose of any examination or investigation pursuant to this By-law, the Corporation shall be entitled to free access to, and to make and retain copies of, all books of account, securities, cash, documents, bank accounts, vouchers, correspondence and records of every description of the Member or person concerned, and no such Member or person shall withhold, destroy or conceal any information, documents or thing reasonably required for the purpose of such examination or investigation.

23.3 The Corporation, may, with respect to any information received:

(a) refer a matter to the applicable Regional Council for consideration in accordance with the provisions of Section 25; or

(b) refer a matter to the appropriate securities regulatory authority, self-regulatory organization or law enforcement agency; or

(c) take such other action under the By-laws or Rules which it considers appropriate in the circumstances.

24. **Co-operation with Other Authorities**

24.1 **Request for Information.** Any Member, Approved Person or any person under the jurisdiction of the Corporation, that is requested by any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange or other trading market to provide information in connection with an

investigation of trading in securities shall submit the requested information, books, records, reports, filings and papers to the commission, authority, organization, exchange or market making the request in such manner and form, including electronically, as may reasonably be prescribed by such commission, authority, organization, exchange or market.

24.2 **Agreements**. The Corporation may enter into in its own name agreements or arrangements with any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange or other trading market or other organization regulating or providing services in connection with securities trading located in Canada or any other country for the exchange of any information (including information obtained by the Corporation pursuant to the By-laws or Rules or otherwise in its possession) and for other forms of mutual assistance for market surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities in Canada or elsewhere.

24.3 **Assistance**. The Corporation may provide to any securities commission or regulatory authority, law enforcement agency, self-regulatory organization, stock exchange or other trading market or other organization regulating or providing services in connection with securities trading located in Canada or any other country any information obtained by the Corporation pursuant to the By-laws or Rules or otherwise in its possession and may provide other forms of assistance for surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities in Canada or elsewhere.

DISCIPLINE

25. **Discipline Procedures.**

25.1 **Power of Regional Councils to Discipline.**

25.1.1 ***Approved Persons.*** The applicable Regional Council shall have power to impose upon an Approved Person or any other person under the jurisdiction of the Corporation any one or more of the following penalties:

(a) a reprimand;

(b) a fine not exceeding the greater of:

(i) $1,000,000.00 per offence; and

(ii) an amount equal to three times the pecuniary benefit which accrued to such person as a result of committing the violation;

(c) suspension of the authority of the person to conduct dealer business for such specified period and upon such terms as the Regional Council may determine;

(d) revocation of the authority of such person to conduct dealer business;

(e) prohibition of the authority of the person to conduct dealer business in any capacity for any period of time;

(f) such conditions of authority to conduct dealer business as may be considered appropriate by the Regional Council;

if, in the opinion of the Regional Council, the person:

(g) has failed to comply with or carry out the provisions of any federal or provincial statute relating to the business of the Member or of any regulation or policy made pursuant thereto;

(h) has failed to comply with the provisions of any By-law, Rule or Policy of the Corporation;

(i) has engaged in any business conduct or practice which such Regional Council in its discretion considers unbecoming or not in the public interest; or

(j) is otherwise not qualified whether by integrity, solvency, training or experience.

25.1.2 ***Members.*** The applicable Regional Council shall have power to impose upon a Member any one or more of the following penalties:

(a) a reprimand;

(b) a fine not exceeding the greater of:

(i) $1,000,000.00 per offence; and

(ii) an amount equal to three times the pecuniary benefit which accrued to the Member as a result of committing the violation;

(c) suspension of the rights and privileges of the Member (and such suspension may include a direction to the Member to cease conducting dealer business) for such specific period and upon such terms as such Regional Council may determine, or, if the rights and privileges have already been suspended under Section 25.15, the continuation of such suspension (including a prohibition on the Member conducting dealer business) for such specified period and upon such terms as such Regional Council may determine;

(d) termination of the rights, privileges and Membership of the Member;

(e) expulsion of the Member from the Corporation;

(f) uch terms and conditions on Membership of the Member as may be considered appropriate by the Regional Council;

if, in the opinion of the Regional Council, the Member:

(g) has failed to carry out any agreement with the Corporation;

(h) has failed to meet any liabilities to another Member or to the public;

(i) has engaged in any business conduct or practice which the Regional Council in its discretion considers unbecoming a Member or not in the public interest;

(j) has ceased to be qualified as a Member by reason of the ownership, integrity, solvency, training or experience of the Member or any of its Approved Persons or other employees or agents, or any person having an ownership interest in the capital or indebtedness of the Member;

(k) has failed to comply with or carry out the provisions of any of the By-laws, Rules or Policies of the Corporation; or

(l) has failed to comply with or carry out the provisions of any applicable federal or provincial statute relating to its business or of any regulation or policy made pursuant thereto.

25.1.3 ***Continuation of Liability*****.** If the rights, privileges or Membership of a Member are suspended or terminated or a Member is expelled from the Corporation, the Member or former Member shall remain liable to the Corporation for all amounts due to the Corporation by it.

25.2 **Regional Council Disciplinary Hearings.**

25.2.1 ***Composition and Quorum*****.** For a hearing of a Regional Council held pursuant to Sections 25.3 or 25.16.3, the quorum shall be two members, at least one of whom shall be a member of the Regional Council and at least one of whom shall be a public member selected from the roster of available public members appointed under Section 19.6. At least two and not more than five members of the Regional Council shall be appointed to conduct such hearing and it shall not be required to give notice of such hearing to all members of the Regional Council. The Chair of the Regional Council may appoint the members to conduct such hearing and may, from time to time, delegate to the Vice-Chair or to any public member of the Regional Council the authority to appoint such members. In the event that more than three persons are appointed to conduct such hearing, public members shall constitute not less than one-third of the panel appointed. Where the respondent in the hearing is an approved individual, the members appointed to conduct such hearing shall reside in a region or community other than the region or community in which the respondent is resident.

25.2.2 ***Chair and Voting.*** A public member shall serve as the chair of such hearing and shall have a vote. At any such hearing any action affirmed by a vote of the majority of those members present and entitled to vote shall constitute the action of the Regional Council. In the event of a tie vote, the chair of the hearing shall have a casting vote.

25.2.3 ***Deemed Regional Council Member.*** Where a hearing is commenced before a Regional Council and the term of office on the Regional Council of a member sitting for the hearing expires or is terminated before the proceeding is disposed of but after any evidence has been heard, the member shall be deemed to remain a member of the Regional Council for the purpose of completing the disposition of the proceeding in the manner as if his or her term of office had not expired or been terminated.

25.2.4 ***Assistance.*** A Regional Council may employ such legal, secretarial or other assistance as it may require.

25.3 **Notice of Hearing.** Before a Regional Council may impose any of the penalties provided for in Section 25.1 hereof (other than pursuant to the approval of a settlement agreement pursuant to Section 25.15), the Member, Approved Person or other person, as the case may be, shall have been summoned before a hearing of such Regional Council, of which at least 14 days' notice shall be given, by way of Notice of Hearing, to the Member or person concerned. Such Notice of Hearing shall be in writing, shall be signed by an officer of the Corporation and contain:

(a) the date, time and place of the hearing;

(b) the purpose of the hearing;

(c) the authority pursuant to which the hearing is held;

(d) a summary of the facts alleged and intended to be relied upon by the Corporation and the conclusions drawn by the Corporation based on the alleged facts; and

(e) the provisions of Sections 25.6 to 25.8 inclusive and a description of the penalties and costs which may be imposed pursuant to Sections 25.1 and 25.5, respectively.

25.3.1 ***Notice Addressed to Corporation.*** Any notice to a Regional Council must be in writing and addressed to the Corporation in care of the office of the Corporation having responsibility for the applicable Regional Council.

25.3.2 ***Notice to Members in the Case of an Individual.*** In the case of an individual summoned before a hearing of a Regional Council, the Member or Members concerned shall be served with a copy of the Notice of Hearing.

25.3.3 ***Publication of Notices.*** A Notice of Hearing shall be published in the same manner as a notice of penalty pursuant to Section 25.16.

25.4 **Right to be Heard.** The Member or person summoned pursuant to Section 25.3 and the Corporation shall be entitled to appear and be heard at the hearing and shall be entitled to be represented by counsel or an agent and to call, examine and cross-examine witnesses.

25.5 **Costs.** The Regional Council may in any case in its discretion require that the Member or person pay the whole or part of the costs of the proceedings before the Regional Council and any investigation relating thereto.

25.6 **Reply.** A Member or person summoned before a hearing of a Regional Council pursuant to a Notice of Hearing shall, within ten days from the date of service of the Notice of Hearing, serve on the Corporation a reply that either:

25.6.1 specifically denies (with a summary of the facts alleged and intended to be relied upon by the Member or person, and the conclusions drawn by the Member or person based on the alleged facts) any or all of the facts alleged or the conclusions drawn by the Corporation in the Notice of Hearing; or

25.6.2 admits the facts alleged and conclusions drawn by the Corporation in the Notice of Hearing and pleads circumstances in mitigation of any penalty to be assessed.

25.7 **Acceptance of Facts and Conclusions.** The Regional Council may accept as having been proven any facts alleged or conclusions drawn by the Corporation in the Notice of Hearing that are not specifically denied in the reply.

25.8 **Failure to Reply or Attend.** If a Member or person summoned before a hearing of a Regional Council by way of a Notice of Hearing fails to:

(a) serve a reply in accordance with Section 25.6; or

(b) attend at the hearing specified in the Notice of Hearing, notwithstanding that a reply may have been served;

the Regional Council may proceed with the hearing of the matter on the date and at the time and place set out in the Notice of Hearing (or on any subsequent date, at any time and place), without further notice to and in the absence of the Member or person, and the Regional Council may accept the facts alleged by the Corporation in the Notice of Hearing as having been proven by the Corporation and may impose any of the penalties described in Section 25.1.

25.9 **Prior Involvement.** Members of a Regional Council participating in a hearing pursuant to Section 25.3 shall not have taken part before the hearing in any investigation of the subject matter of the hearing.

25.10 **Open to the Public.** A hearing pursuant to Section 25.3 shall be open to the public except where the Regional Council is of the opinion that intimate financial or personal matters or other matters may be disclosed at the hearing which are of such a nature, having regard to the circumstances, that the desirability of avoiding disclosure thereof in the interests of any person affected or in the public interest outweighs the desirability of adhering to the principle that hearings be open to the public, in which case the Regional Council may hold the hearing *in camera.*

25.11 **Jurisdiction.**

25.11.1 ***Former Members.*** For the purposes of Sections 21 to 25 inclusive, any Member, Approved Person or other person subject to the jurisdiction of the Corporation shall remain subject to the jurisdiction of the Corporation notwithstanding that such Member has ceased to be a Member, Approved Person or other person subject to the jurisdiction of the Corporation.

25.11.2 ***Limitation.*** No proceedings shall be commenced pursuant to Section 25.3 against a former Member or person referred to in Section 25.11.1 unless a Notice of Hearing has been served upon such Member or person no later than five years from the date upon which such Member or person ceased to be a Member or held the relevant position with the Member, respectively.

25.12 **Parties to Proceedings and Witnesses.**

25.12.1 ***Parties to Proceedings.*** The parties to proceedings before a Regional Council are:

(a) the Corporation, which shall be represented by the Corporation, or any person designated by it; and

(b) in the case of:

(i) an individual, the individual and, in the discretion of the Council, the Member concerned;

(ii) a Member, the Member.

25.12.2 ***Required Attendance or Production.*** Every Member, Approved Person and other person under the jurisdiction of the Corporation may be required by a Regional Council:

(a) to attend before it at any of its proceedings and give information respecting any matter involved in the proceeding; and

(b) to produce for inspection and provide copies of any books, records and accounts of such person, or within such person's possession and control, relevant to the matters being considered.

25.12.3 ***Required Attendance of Employee or Agent of Member.*** In the event that a Regional Council requires the attendance before it of any employee or agent of a Member who is not under the jurisdiction of the Corporation, the Member shall direct such employee or agent to attend and to give information or make such production as could be required of a person referred to in Section 25.13.2.

25.13 **Reasons.** Any decision of a Regional Council at a hearing held pursuant to Section 25.3 shall be in writing and shall contain a concise statement of the reasons for the decision. Notice of a decision shall be delivered to the Secretary who shall then promptly give notice, in the case of an individual, to the individual and to the Member

concerned, or in the case of a Member, to the Member. A copy of the decision shall accompany the notice.

25.14 **Suspensions in Certain Circumstances.**

25.14.1 ***Power to Suspend.*** Notwithstanding anything in this Section 25, in the event that:

(a) the registration of a Member as a mutual fund dealer under any securities legislation of any province or territory in which the Member is carrying on business is suspended or cancelled, or a Member fails to renew any such registration which has lapsed; or

(b) a Member makes a general assignment for the benefit of its creditors or is declared bankrupt or makes an authorized assignment or a proposal to its creditors under the *Bankruptcy and Insolvency Act*, or a winding-up order is made in respect of a Member or a receiver or other officer with similar powers is appointed in respect of all or any part of the undertaking and property of a Member; or

(c) a stock exchange, securities commission, self-regulatory organization or other securities regulatory authority suspends the membership or privileges thereof of a Member who is a member of such exchange or self-regulatory organization;

then the applicable Regional Council shall have the power and, with respect to an event referred to in Section 25.14.1(b) above, shall be obliged, forthwith upon receiving notice of such event, to suspend the rights and privileges of the Member for such period and on such terms and conditions as such Regional Council may in its discretion determine.

25.14.2 ***Further Suspension, Termination of Rights and Privileges, Expulsion.*** In any of the events referred to:

(a) in Sections 25.14.1(a) or (c), if the Member fails to take appropriate proceedings within the time provided for by the legislation or stock exchange, securities commission, self-regulatory organization or regulatory authority rules for a review of or by way of appeal from such suspension or cancellation of registration or membership, or fails within such period as the Regional Council may prescribe to renew any such registration which has lapsed, or if, notwithstanding such review and appeal, such suspension or cancellation of registration or membership, is confirmed and becomes final, the Regional Council may, either with or without notice to the Member, suspend the Member for a further period, terminate the rights, privileges and Membership of the Member or expel the Member from the Corporation, and such suspension, termination or expulsion shall take immediate effect and there shall be no review or appeal therefrom. If upon review or appeal the registration or membership of a Member under the legislation, stock exchange, self-regulatory organization or regulatory authority rules is reinstated, the Regional Council may reinstate the Member and cancel any suspension imposed by it upon the Member.

(b) in Section 25.14.1(b), if the Member fails within such period as the Regional Council may prescribe to satisfy the claims of its creditors and/or obtain a discharge under the *Bankruptcy and Insolvency Act* or cause the winding-up order or receivership to be discharged or terminated, the Regional Council may, either with or without notice to the Member, suspend the Member for a further period, terminate the rights, privileges and Membership of the Member or expel the Member from the Corporation, and such suspension, termination or expulsion shall take immediate effect. If the Member satisfies its creditors and/or obtains a discharge under the *Bankruptcy and Insolvency Act* or causes the winding-up order or receivership to be discharged or terminated within such period as the Regional Council may determine, the Regional Council may reinstate the Member upon such terms and conditions as the Regional Council may determine and cancel any suspension imposed by it upon the Member.

25.14.3 ***Cause of Financial Loss to the Public.*** Notwithstanding anything in Section 25, if, as a result of information received by the Chair or any Vice-Chair of the applicable Regional Council, such Chair or Vice-Chair after consultation with the President or one or more members of the Executive Committee of the Board of Directors is of the opinion that a Member has breached any By-law, Rule or Policy of the Corporation and that such breach or breaches is likely to result in financial loss to the public, the Chair or Vice-Chair may immediately suspend the rights and privileges of such Member and direct such Member to immediately cease dealing with the public. If the Chair or Vice-Chair of the Regional Council acts under the provisions of this Section 25.14.3, he or she shall summon the Member to appear before a hearing of the applicable Regional Council to be held within 15 days upon notice to the Member, with such notice and hearing to be in accordance with the provisions of this Section 25, as applicable.

25.14.4 ***Failure to Pay Fine or Comply with Condition.*** In the event that a fine or condition imposed by a Regional Council pursuant to Section 25.1 is not paid or complied with, respectively, within the time prescribed by the Regional Council, the applicable Regional Council may, upon application by the Corporation, and without further notice to the Member or person concerned, suspend the authority of such person to conduct dealer business or the rights and privileges of such Member, respectively, until such fine is paid or condition fulfilled.

25.14.5 ***Other Proceedings.*** Nothing contained in Section 25.15 shall prevent any other proceedings being

taken against a Member, Approved Person or other person pursuant to any other provisions of Section 25.

25.15 **Settlement Agreements.**

25.15.1 ***Power to Enter into Settlement Agreement.*** The Corporation or any other person designated by it or the Board of Directors may negotiate a settlement agreement with a Member, Approved Person or other person under the jurisdiction of the Corporation, in respect of any matters for which the Member or person could be penalized on the exercise of the discretion of a Regional Council pursuant to Section 25.1.

25.15.2 ***Contents of Settlement Agreement.*** A settlement agreement shall be in writing and be signed by or on behalf of the Member or person and shall contain:

(a) a statement of facts sufficient to identify the matter to which the settlement agreement relates;

(b) a reference to any statutes or regulations thereto, By-law, Rules or Policies of the Corporation with which the Member or person has not complied and a statement as to future compliance therewith;

(c) the consent and agreement of the Member or person to the terms of the settlement agreement;

(d) the acceptance of the penalty to which the Member or person could be subject pursuant to Section 25.1;

(e) the waiver of the rights of the Member or person to a hearing pursuant to the By-laws and all rights of review thereunder; and

(f) such other matters not inconsistent with Section 25.15.2(a) to (e), inclusive, which may be agreed upon including, without limitation, the agreement by the Member or person to pay the whole or part of the costs of the investigation and any proceedings relating to the matters which are the subject of the settlement agreement.

25.15.3 ***Review and Determination by Regional Council.*** Such settlement agreement shall, on the recommendation of:

(a) the Corporation; and

(b) the Regional Director for the applicable Region,

be referred to the applicable Regional Council which shall:

(c) accept the settlement agreement;

(d) reject it.

A Regional Council shall not consider a settlement agreement pursuant to this Section unless at least 14 days' notice of the meeting of the Council has been given in accordance with Section 25.16 specifying:

(e) the date, time and place of the meeting; and

(f) the purpose of the meeting with sufficient information to identify the Member or Approved Person involved and the general terms of the settlement agreement.

25.15.4 ***Binding Upon Acceptance or Imposition.*** A settlement agreement shall only become binding in accordance with its terms upon such acceptance and, in such event, the Member or person shall be deemed to have been penalized by the applicable Regional Council for the purpose of giving notice thereof.

25.15.5 ***Rejection of Settlement Agreement by Regional Council.*** If a Regional Council rejects a settlement agreement pursuant to Section 25.15.3, the provisions of Sections 25.1 to 25.13, inclusive, shall apply, provided that no member of the Regional Council who participated in the deliberations of the Regional Council rejecting the settlement agreement shall participate in any hearing conducted by the Regional Council with respect to the same matters which are the subject of the agreement.

25.15.6 ***Without Prejudice.*** All negotiations of a settlement agreement shall be without prejudice and the negotiations may not be used as evidence or referred to in any hearing.

25.16 **Publication of Notice and Penalties.**

25.16.1 ***Notice Requirements.*** If and whenever:

(a) a Member (except as provided by Section 25.16.1(b) hereof), Approved Person or other person is penalized by a Regional Council, notice of the penalty shall be given by the Corporation forthwith;

(b) the rights and privileges of a Member are suspended or terminated, or a Member is expelled from the Corporation, notice of the penalty and notice of the disposition of any review from the imposition thereof shall be given forthwith by the Corporation. If such penalty is subject to review the notice shall so indicate;

25.16.2 ***Content of Notice.*** A notice of penalty given pursuant to Section 25.16.1 shall include a summary of the facts, shall specify the By-law or Rules violated and the penalty assessed, and shall include the name of the Member or person upon which the penalty is imposed and, in the case of a penalty imposed upon an Approved Person or other person, shall include the name of the Member employing or retaining such person at the relevant time.

25.16.3 ***Method of Giving Notice.*** A notice of penalty given pursuant to Section 25.16.1 shall be given:

(a) by publication in a Corporation bulletin;

(b) by delivery of the notice to a news service or newspaper having national distribution;

(c) by delivery of the notice to any securities commission, stock exchange, self-regulatory organization or other securities regulatory authority having jurisdiction over the Member or individual concerned, and

(d) to such other persons, organizations or corporations, and in such other manner as the Regional Council imposing the penalty, and/or as the Corporation from time to time, deems advisable.

25.17 **Effect and Review of Regional Council Decisions**

25.17.1 ***Effect Only in Applicable Region.*** Any decision of a Regional Council by which a Member's rights and privileges are suspended or terminated or a Member is expelled from the Corporation shall have effect only in the Region where such Regional Council has jurisdiction, unless and until otherwise ordered by the Board of Directors.

25.17.2 ***Review.*** Subject to the provisions of Section 25.17.3, in the event of a decision by a Regional Council:

(a) by which a Member's rights and privileges are suspended or terminated or a Member is expelled from the Corporation, the Board of Directors shall, upon the application of either the Corporation or the Member concerned made within 21 days of receiving notice of the decision of the Regional Council, review the decision; and:

(i) confirm or modify the decision of the Regional Council in its application to that Region; or

(ii) confirm or modify the decision of the Regional Council and extend its application and effect to all Regions of the Corporation; or

(b) by which it imposes a fine or conditions upon a Member, the Board of Directors shall, upon the application of either the Corporation or the Member concerned made within 21 days of receiving notice of the decision of the Regional Council, review the said decision and confirm or modify the decision of the Regional Council.

25.17.3 ***Restrictions on Determination by the Board of Directors.*** The Board of Directors shall not, pursuant to Section 25.17.2:

(a) modify any decision of a Regional Council in its application to the Region where such Regional Council has jurisdiction; or

(b) extend the application and effect of a decision of another Regional Council to a Region,

if the securities commission having jurisdiction in such Region directs that such decisions shall not be modified, or extended into the Region where it has jurisdiction, as the case may be.

25.17.4 ***Review Hearing.*** With respect to a review pursuant to Section 25.17.2:

(a) the provisions of Sections 25.1 apply *mutatis mutandis* to any review by the Board of Directors;

(b) the Board of Directors:

(i) shall consider the record of the proceedings before the Regional Council;

(ii) shall permit the parties to appear before it on reasonable notice, with counsel or by agent, to make submissions and the provisions of Section 25.13 apply *mutatis mutandis*; and

(c) Members of the Board of Directors participating in a review hearing pursuant to this Section 25.17.4 shall not have taken part before the hearing in any proceedings with respect to the decision which is being reviewed. Subject to the provisions of Section 27, decisions of the Board of Directors pursuant to this Section 25.17.4 are final and there shall be no further review of such decisions within the Corporation.

25.17.5 ***Prohibition Against Review By Court or Tribunal.*** Except as provided in Section 27, no proceedings shall be taken in any court or other tribunal to question or review any decision, order, direction, declaration or ruling of a Regional Council or the Board of Directors or to prohibit or restrain any Regional Council or the Board of Directors or their proceedings.

26. **Rules, Forms and Other Instruments**

26.1 **Power to Make, Amend or Repeal Rules.** The Board of Directors may make and from time to time amend or repeal such Rules not inconsistent with the Letters Patent or By-laws, as in its discretion may be advisable for carrying out the provisions of the By-laws or generally for the purposes of the Corporation, and all such Rules for the time being in force, unless expressly otherwise provided, shall be binding upon all Members.

26.2 **Forms.** Where pursuant to any By-law, Rule or Policy, a Form may be prescribed or adopted, any such Form (including any instructions, directions or notes in such Forms) so prescribed or adopted shall have the same force and effect as the By-law, Rule or Policy pursuant to which it is prescribed or adopted. Any reference in the By-laws, Rules or Policies to compliance with the By-laws, Rules or

Policies shall be deemed to include a reference to any Forms.

26.3 **Force and Effect.** The Rules made in accordance with Section 26.1 shall be effective and remain in force until the Annual Meeting next following the date of the making of such Rules and, if confirmed by such Annual Meeting, shall continue in force thereafter unless and until amended or repealed.

26.4 **Other Instruments**. The Corporation may develop and issue to Members such guidelines, policies, bulletins, notices and other communications relevant to the By-laws and Rules or the business and activities of Members, their Approved Persons or other employees or agents to assist in the interpretation, application of and compliance with the By-laws, Rules and legislation relevant to such business and activities. The Board of Directors and a Regional Council may refer to such instruments in the interpretation and application of the By-laws and Rules.

REVIEW BY APPLICABLE SECURITIES COMMISSION

27. **Review of Decisions.**

27.1 Any Member, Approved Person or other person directly affected by a decision of the Board of Directors or a Regional Council in respect of which no further review or appeal is provided in the By-laws may request any securities commission given jurisdiction in the matter under its enabling legislation to review such decision and notice in writing of such appeal shall be given forthwith to the Corporation.

GENERAL ADMINISTRATION

28. **Head Office.** The head office of the Corporation shall be in the City of Toronto in the Province of Ontario.

29. **Seal.** The seal, an impression of which is stamped in the margin hereof, shall be the seal of the Corporation.

30. **Execution of Instruments.** Contracts, documents or any instruments in writing requiring the signature of the Corporation may be signed by

30.1 any one of the Chair of the Board, the Vice-Chair of the Board, the President and Chief Executive Officer, the Chief Operating Officer or a Vice-President together with any one of the Secretary or the Treasurer;

30.2 any two directors; or

30.3 any one of the aforementioned officers together with any one director;

and all contracts, documents and instruments in writing so signed shall be binding upon the Corporation without any further authorization or formality. The Board of Directors shall have power from time to time by resolution to appoint any officer or officers or any person or persons on behalf of the Corporation either to sign contracts, documents and instruments in writing generally or to sign specific contracts, documents or instruments in writing.

The term "contracts, documents or instruments in writing" as used in this By-law shall include but not be limited to deeds, mortgages, hypothecs, charges, conveyances, transfers and assignments of property real or personal, immovable or movable, agreements, releases, receipts and discharges for the payment of money or other obligations, conveyances, transfers and assignments of shares, share warrants, stocks, bonds, debentures or other securities and all paper writings.

The seal of the Corporation when required may be affixed to any instruments in writing signed as aforesaid or by any officer or officers appointed by resolution of the Board of Directors.

31. **Cheques, Drafts, Notes, Etc.** All cheques, drafts or orders for the payment of money and all notes and acceptances and bills of exchange shall be signed by such officer or officers or person or persons, whether or not officers of the Corporation, and in such manner as the Board of Directors may from time to time designate by resolution.

32. **Notices.**

32.1 **Service**. Any notice or other document required by the Act, the Regulations, the Letters Patent or the By-laws to be sent to any Member, director or Approved Person or to the auditor shall be delivered personally or sent by prepaid mail or by facsimile to any such Member, director or Approved Person at their latest address as shown in the records of the Corporation and to the auditor at its business address, or if no address be given therein then to the last address of such Member, director or Approved Person known to the Secretary; provided always that notice may be waived or the time for the notice may be waived or abridged at any time with the consent in writing of the person entitled thereto.

32.2 **Signature to Notices**. The signature of any director or officer of the Corporation to any notice or document to be given by the Corporation may be written, stamped, typewritten or printed or partly written, stamped, typewritten or printed.

32.3 **Computation of Time**. Where a given number of days' notice or notice extending over a period is required to be given under the By-laws or Letters Patent of the Corporation the day of service or posting of the notice shall not, unless it is otherwise provided, be counted in such number of days or other period.

32.4 **Proof of Service**. With respect to every notice or other document sent by post it shall be sufficient to prove that the envelope or wrapper containing the notice or other document was properly addressed as provided in Section 32.1 and put into a post office or into a letter box. A certificate of an officer of the Corporation in office at the time of the making of the certificate as to facts in relation to the sending or delivery of any notice or other document to any Member, director, officer or auditor or publication of any notice or other document shall be conclusive evidence

thereof and shall be binding on every Member, director, officer or auditor of the Corporation as the case may be.

33. **By-laws**. The Board of Directors may from time to time enact By-laws relating in any way to the Corporation or to the conduct of its affairs, including, but not limited to, By-laws providing for applications for supplementary letters patent, and may from time to time by by-law amend, repeal or re-enact the By-laws but no By-law shall be effective until sanctioned by at least 2/3 of the votes cast at a meeting of the Members duly called for the purpose of considering same, and the repeal or amendment of By-laws not embodied in the Letters Patent shall not be enforced or acted upon until the approval of the Minister under the Act in respect thereof has been obtained.

34. **Auditors.** The Members shall at each annual meeting appoint an auditor to audit the accounts of the Corporation for report to Members who shall hold office until the next following annual meeting; provided, however, that the directors may fill any casual vacancy in the office of the auditor. The remuneration of the auditor shall be fixed by the Board of Directors.

35. **Financial Year.** The financial year of the Corporation shall terminate on the 30th day of June in each year or on such other date as the directors may from time to time by resolution determine.

36. **No Actions Against the Corporation.** No Member (including in all cases a Member whose rights and privileges have been suspended or terminated and a Member who has been expelled from the Corporation or whose Membership has been forfeited) and Approved Person or any other person who is subject to the jurisdiction of the Corporation, shall be entitled, subject to the provisions of Section 27, to commence or carry on any action or other proceedings against the Corporation or against the Board of Directors, the Executive Committee, any Regional Council, any Committee thereof, or against any officer, employee or agent of the Corporation or member or officer of any such Board of Directors, Committee or Council or against any Member's auditor, in respect of any penalty imposed or any act or omission done or omitted under the provisions of and in compliance with or intended compliance with the provisions of any By-law, Rule or Policy.

37. **Use of Name: Liabilities: Claims.**

37.1 **Use of Name.** No Member shall use the name of the Corporation on letterheads or in any circulars or other advertising or publicity matter, except to the extent and in such form as may be authorized by the Board of Directors.

37.2 **Liabilities.** No liability shall be incurred in the name of the Corporation by any Member, officer or committee without the authority of the Board of Directors.

37.3 **Claims.** Whenever the Membership of a Member ceases for any reason whatsoever, neither the former Member nor its heirs, executors, administrators, successors, assigns or other legal representatives, shall have any interest in or claim on or against the funds and property of the Corporation.

38. **Exemptions**

The Board of Directors may exempt any Member, Approved Person, or any other person subject to the jurisdiction of the Corporation, or any group or class of the foregoing persons, from the requirements of any provision of the By-laws, Rules and Forms where it is satisfied that to do so would not be prejudicial to the interests of the Members, their clients or the public, and in granting such an exemption the Board of Directors may impose such terms and conditions as are considered necessary or desirable. The Board of Directors shall, in its discretion, determine whether it is appropriate for notice of the exemption to be given by all or any of the means specified in Section 25.16.3.

39. **Transition Periods for By-laws and Rules**

The Board of Directors may suspend or modify the application of any By-law or Rule, or provision thereof, which has been enacted, made, sanctioned or confirmed, as the case may be, and is effective, for such period of time as it may determine in its sole discretion not exceeding two years from the effective date of the relevant By-law or Rule in order to facilitate the orderly application of and compliance with such By-law or Rule to or by all or any number or class of Members, Approved Persons or other persons subject to the jurisdiction of the Corporation. Any such suspension or modification may be made either before or after the relevant By-law or Rule has become effective, and notice of the suspension or modification shall be given promptly to all Members and the securities commission in any jurisdiction where such By-law or Rule would otherwise be in effect with respect to Members, Approved Persons and other persons subject to the jurisdiction of the Corporation. No such suspension shall unfairly discriminate between Members, Approved Persons or other persons subject to the jurisdiction of the Corporation, and no such modification shall impose on all or any of the Members, Approved Persons or other persons subject to the jurisdiction of the MFDA a requirement that is more onerous or stricter than the requirements of the By-law or Rule that is subject to the suspension or modification.

_____ _____

President and Chief Executive Officer Secretary

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Draft: June 9, 2000
FOR PUBLICATION

MUTUAL FUND DEALERS ASSOCIATION OF CANADA/
ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS

RULES

NOTE TO READER: These draft Rules of the Mutual Fund Dealers Association of Canada / Association canadienne des courtiers de fonds mutuels (MFDA) have been prepared for comment in connection with the application of MFDA for recognition as a self-regulatory organization pursuant to applicable provincial securities legislation. The draft Rules, together with the By-laws, Forms and Policies of MFDA are based on statutory requirements, the recommendations of the Board of Directors of the MFDA and various MFDA Industry Committees, current industry practices, the standards of other industry and self-regulatory organizations and the announced requirements of securities regulators. Further amendments may be made as the MFDA develops and regulatory policy for MFDA Members is determined. The application of some of the draft Rules may be delayed or modified for limited periods of time to permit orderly transition and compliance by Members and Approved Persons.

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Section

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

1 RULE NO. 1 - BUSINESS STRUCTURES AND QUALIFICATIONS

1.1 BUSINESS STRUCTURES

1.1.1 **Members.** No Member or Approved Person (as defined in By-law 1.1) in respect of the Member shall, directly or indirectly, engage in any dealer business (as defined in By-law 1.1) except in accordance with the following:

(a) all such dealer business is carried on for the account of the Member in accordance with the By-laws and Rules, other than such business as relates solely to trading in deposit instruments;

(b) all revenues, fees or consideration in any form relating to such dealer business is paid or credited directly to the Member and is recorded on the books of the Member;

(c) the relationship between the Member and any person conducting dealer business on account of the Member is that of:

(i) an employer and employee, in compliance with Rule 1.1.4,

(ii) a principal and agent, in compliance with Rule 1.1.5, or

(iii) an introducing dealer and carrying dealer, in compliance with Rule 1.1.6;

(d) the business or trade or style name under which such dealer business is conducted is in accordance with Rule 1.1.7.

1.1.2 **Compliance by Approved Persons.** Each Approved Person who conducts or participates in any dealer business in respect of a Member in accordance with Rule 1.1.1.(c)(i) or (ii) shall comply with the By-laws and Rules as they relate to the Member or such Approved Person.

1.1.3 **Service Arrangements.** A Member or Approved Person may engage the services of a person who is not a Member or an Approved Person to provide administrative services to the Member or Approved Person, as the case may be, provided that:

(a) the administrative services do not in themselves constitute dealer business or duties or responsibilities that are required to be performed by the Member or Approved Person itself or him\herself pursuant to the By-law, Rules or applicable securities legislation;

(b) any remuneration or compensation in any form in respect of such services shall only be paid or credited by the Member or Approved Person engaging the services, as the case may be, directly to the person providing the services, and the payment or credit of such remuneration or compensation shall be recorded in the books and records required to be maintained in accordance with the By-laws and Rules by the Member or Approved Person engaging such services;

(c) the Member or Approved Person engaging the services shall remain responsible for compliance with the By-laws and Rules and any applicable legislation;

(d) the person providing services shall prepare and maintain books and records in accordance with Rule 5 in respect of the business of the Member or Approved Person for which services are provided, and such books and records shall be available for review by the Member or Approved Person during normal business hours and by the Corporation in accordance with the By-laws and Rules; and

(e) all material terms of the services to be engaged shall be evidenced in writing and a copy of such terms, together with any amendments thereto from time to time or termination, shall be provided by the Member or Approved Person promptly to the Corporation upon request, together with any other information relating thereto as may be requested by the Corporation.

1.1.4 **Employees.** A Member may conduct its dealer business by Approved Persons employed as employees by it provided that:

(a) any such employee is registered or licensed, in the manner necessary, and is in good standing, under the applicable legislation in the province or territory where the employee proposes to act;

(b) the Member shall be responsible for, and shall supervise, the conduct of the employee as an Approved Person in respect of the dealer business including compliance with applicable legislation and the By-laws and Rules;

(c) the Member shall be liable to third parties (including clients) for the acts and omissions of the employee relating to its dealer business;

(d) the employee is in compliance with the legislation, By-laws and Rules applicable to the employee as an Approved Person; and

(e) where the Member and the Approved Person employed as an employee have entered into a written agreement, it shall not contain provisions which are inconsistent with an employment relationship or with the

requirements set out in paragraphs (a) to (d) inclusive, of Rule 1.1.4.

1.1.5 **Agents.** A Member may conduct its dealer business by Approved Persons retained or contracted by it as agents provided that:

(a) any such agent is registered or licensed in the manner necessary, and is in good standing, under the applicable legislation in the province or territory where the agent proposes to act;

(b) the Member shall be responsible for, and shall supervise, the conduct of the agent in respect of the dealer business including compliance with applicable legislation and the By-laws and Rules;

(c) the Member shall be liable to third parties (including clients) for the acts and omissions of the agent relating to its dealer business;

(d) the agent is in compliance with the legislation, By-laws and Rules applicable to the agent;

(e) the financial institution bonds and insurance policies required to be maintained by the Member pursuant to Rule 4 cover and relate to the conduct of the agent;

(f) all books and records prepared and maintained by the agent in respect of such dealer business of the Member shall be in accordance with Rule 5 and applicable legislation, shall be the property of the Member and shall be available for review by and delivery to the Member during normal business hours;

(g) all dealer business conducted by the agent is in the name of the Member;

(h) the agent shall not conduct dealer business with or in respect of any person other than the Member;

(i) if the agent is engaged in or carrying on any business or activity other than dealer business conducted on behalf of the Member, including any business or activity which is subject to regulation by any regulatory authority other than a securities commission, compliance with the terms of the agreement referred to in paragraph (k) shall be monitored and enforced directly by the Member and not by or through any other person including another employer or principal of the agent;

(j) the terms or basis on which the agent may be engaged in or carry on any business or activity other than dealer business as referred to in paragraph (i) shall not prevent or impair the ability of the Member or the Corporation from monitoring and enforcing compliance by the agent with the terms of the agreement referred to in paragraph (k) or the By-laws or Rules; and

(k) the Member and the agent shall have entered into an agreement in writing, which shall be provided promptly to the Corporation upon request, containing terms which include the provisions of paragraphs (a) to (j), inclusive, and which do not include provisions which are inconsistent with paragraphs (a) to (j), and shall provide the Corporation with a certificate signed by an officer or director of such Member and, upon request by the Corporation, shall provide an opinion of counsel, confirming the foregoing and that the agency relationship contemplated thereby is effective and in compliance with such provisions;

1.1.6 **Introducing and Carrying Arrangement**

[***Note***: It is anticipated that other introducing and carrying arrangements may be developed based on comments received during the public comment period.]

(a) **Permitted Arrangements**. A Member may enter into an arrangement with another Member pursuant to which the accounts of one Member (the "introducing dealer") are carried by the other Member (the "carrying dealer") provided that:

(i) the arrangement shall satisfy the requirements of a Type 1 [or Type 2 etc.] carrying arrangement described in Rule 1.1.6(b) [and (c) etc., respectively];

(ii) an introducing dealer shall not introduce accounts to more than one Member or to any person who is not a Member;

(iii) the Members shall enter into a written agreement in a form prescribed by the Corporation evidencing the arrangement and reflecting the requirements of Rule 1.1.6(b) and such other matters as may be required by the Corporation;

(iv) the arrangement (including the form of agreement referred to in Rule 1.1.6(b) and any amendment to or termination of the arrangement or agreement, shall have been approved by the Corporation before it is to become effective; and

(v) the arrangement shall be in compliance with the By-laws and Rules and the securities legislation applicable to either of the Members, and shall be in the form referred to in Rule 1.1.6(b).

(b) **Terms of Type 1 Arrangement**. A Member may enter into an agreement with another Member in accordance with Rule 1.1.6(a) if it satisfies the following requirements:

(i) Minimum Capital. The introducing dealer and the carrying dealer shall maintain at all times minimum capital of a Level 1 Dealer and a Level 4 Dealer, respectively;

(ii) Reporting of Client Balances. In calculating the risk adjusted capital required pursuant to Rule 3.1.1 and Form 1, the carrying dealer shall, and the introducing dealer shall not, report all accounts of the clients (introduced by the introducing dealer to the carrying dealer) in nominee name on the carrying dealer's Form 1 and Monthly Financial Report;

(iii) Deposit. Any deposit provided to the carrying dealer by the introducing dealer pursuant to the terms of the agreement between them shall be segregated in accordance with Rule 3.3 by the carrying dealer and shall be held by the carrying dealer in a separate designated trust account for the introducing dealer;

The deposit provided by the introducing dealer to the carrying dealer shall be reported by the introducing dealer as an allowable asset on its Form 1 and Monthly Financial Report;

(iv) Segregation of Client Cash and Securities. The carrying dealer shall be responsible for holding and segregating all cash and securities held for clients introduced to it by the introducing dealer in accordance with the requirements of Rule 3.3;

(v) Trust Accounts. The carrying dealer shall be responsible for and shall maintain in its name any trust accounts established in respect of cash received for the account of clients introduced to it by the introducing dealer;

(vi) Insurance. The introducing broker shall maintain minimum insurance in the amount of $200,000 in respect of the coverages required and in accordance with Rule No. 4. The introducing dealer and the carrying dealer each shall be responsible for providing Financial Institution Bond coverage for Clause (A) fidelity insurance under Rule 4;

(vii) Amount of Insurance. The carrying dealer shall include all accounts introduced to it by the introducing dealer held in nominee name in its calculation of the "base amount" asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E) under Rule 4;

(viii) Disclosure and Acknowledgement on Account Opening. At the time of opening each client account, the introducing dealer shall obtain from the client an acknowledgement in writing that the introducing dealer has advised the client of the introducing dealer's relationship to the carrying dealer and of the relationship between the client and the carrying dealer;

(ix) Contracts, Statements and Correspondence. The name and role of the carrying dealer shall, and the name and role of the introducing dealer may in lesser size, be shown on all contracts, statements, correspondence, client communications, and other documentation sent by either the introducing dealer or the carrying dealer, and both shall be parties to any client guarantee documentation. The use of business or trade or style names shall be in accordance with Rules 1.1.7(c) to (f), inclusive. The carrying dealer shall be responsible for sending account statements and confirmations to clients introduced to it by the introducing dealer as required by the By-laws and Rules;

(x) Clients Introduced to the Carrying Dealer. Each client introduced to the carrying dealer by the introducing dealer shall be considered a client of the carrying dealer for the purposes of complying with the By-laws and Rules; and

(xi) Responsibility for Compliance. Unless otherwise specified in Rule 2 or in this Rule 1.1.6, the introducing dealer and the carrying dealer shall be jointly and severally responsible for compliance with the By-laws and Rules for each account introduced to the carrying dealer by the introducing dealer.

(c) **[Terms of Type 2 Arrangement**. A Member may enter into an agreement with another Member in accordance with Rule 1.1.6(a) if it satisfies the following requirements:]

1.1.7 **Business Names, Styles, Etc.**

(a) Except as permitted pursuant to Rule 1.1.6 with respect to introducing dealers and carrying dealers, all dealer business carried on by a Member or by any person on its behalf is in the name of the Member or a business or trade or style name owned by the Member or an affiliated corporation, and the Member shall notify the Corporation prior to the use of any business or trade or style name other than the Member's legal name;

(b) No Member or Approved Person shall use any business or trade or style name that is used by any other Member, unless the relationship with such other Member is that of an introducing dealer and carrying dealer, in compliance with Rule 1.1.6;

(c) No Member or Approved Person shall use any business or trade or style name that is deceptive, misleading or likely to deceive or mislead the public;

(d) A Member or Approved Person identifying him/herself or itself to the public under a business or trade or style name, shall set out both the business or trade or style name and the Member's legal name in all materials communicated to clients or the public;

(e) No Member shall permit its business or trade or style name to be used by an Approved Person or any other person in connection with any business other than dealer business of such Member; and

(f) The Corporation may prohibit a Member from using any business or trade or style name in a manner that is contrary to any provision of this Rule 1.1.7 or that is objectionable or contrary to the public interest.

1.2 **INDIVIDUAL QUALIFICATIONS**

1.2.1 **Salespersons**

(a) **Course Requirements**. Each Approved Person who is a salesperson and who trades or deals in securities for the purposes of any applicable legislation in respect of a Member shall have successfully completed any one of the following courses:

(i) the Canadian Securities Course offered by the Canadian Securities Institute;

(ii) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada; or

(iii) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers.

(b) **Registration with Applicable Securities Commission.** No Member shall permit any Approved Person who is a salesperson and who trades or deals in securities for the purposes of any applicable legislation unless such person:

(i) is registered and/or licensed, in the manner necessary, and is in good standing, under the applicable securities legislation to conduct such business; and

(ii) executes and delivers to the Corporation an agreement in a form as prescribed from time to time by the Corporation agreeing, among other things, to be subject to, comply with and be bound by the By-laws and Rules.

(c) **Training and Supervision.** Upon commencement of trading or dealing in securities for the purposes of any applicable legislation on behalf of a Member, all Approved Persons who are salespersons shall complete a training program within 90 days of such commencement and a concurrent six month supervision period in accordance with such terms and conditions as may be prescribed from time to time by the Corporation, unless he or she has completed a training program and supervision period in accordance with this Rule with another Member or was licensed or registered in the manner necessary, and is in good standing, under applicable securities legislation to trade in mutual fund securities prior to the date of this Rule becoming effective.

(d) **Dual Occupations.** An Approved Person may have, and continue in, another gainful occupation provided that:

(i) the securities commission in the jurisdiction in which the Approved Person carries on or proposes to carry on business specifically permits him or her to devote less than his or her full time to the business of the Member for which he or she acts on behalf of;

(ii) the securities commission in the jurisdiction in which the Approved Person carries on or proposes to carry on business does not prohibit an Approved Person from engaging in such gainful occupation;

(iii) the Member for which the Approved Person carries on business either as an employee or agent is aware of and acknowledges in writing to the Corporation its responsibility for the supervision of such Approved Person in respect of that business;

(iv) such Member establishes and maintains procedures to ensure continuous service to clients and to address potential conflicts of interest; and

(v) any such gainful occupation of the Approved Person must not be capable of bringing the Corporation, its Members

or the mutual fund industry into disrepute.

(e) **Financial Planning.** Any Approved Person that engages in financial planning services must comply with the requirements of any applicable legislation in connection therewith.

(f) **Business Titles**. No Approved Person shall hold him or herself out to the public in any manner including, without limitation, by the use of any business name or designation of qualifications or professional experience that deceives or misleads, or could reasonably be expected to deceive or mislead, a client or any other person as to the proficiency or qualifications of the Approved Person under the Rules or any applicable legislation.

1.2.2 **Branch Managers**

(a) **Proficiency Requirements.** An individual may not be designated by the Member as a branch manager pursuant to Rule 2.5.2(a) or a co-branch manager pursuant to Rule 2.5.2(c) unless the individual has:

(i) been licensed or registered previously under applicable securities legislation as a trading partner, director, officer or compliance officer of a mutual fund dealer; or

(ii) has successfully completed any one of the following courses:

(A) the Canadian Securities Course offered by the Canadian Securities Institute,

(B) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada, or

(C) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers,

and, any one of the following courses:

(D) the Branch Managers' Course offered by the Canadian Securities Institute,

(E) the Mutual Fund Branch Managers' Course offered by the Investment Funds Institute of Canada, or

(F) the Branch Compliance Officers Course offered by the Institute of Canadian Bankers.

(b) **Experience Requirements.** In addition to the requirements set out in Rule 1.2.2(a), each branch manager in respect of a Member shall:

(i) have acted as a salesperson, trading partner, director, officer or compliance officer registered under the applicable securities legislation for a minimum of two years; or

(ii) have a minimum of two years of equivalent experience to that of an individual described in Rule 1.2.2(b)(i); and

(iii) be registered or licensed as a branch manager under the applicable securities legislation and comply with the requirements of such legislation in connection therewith.

*[**Note**: The MFDA may delay the effective date of the experience requirement in paragraph 1.2.2(b) above in certain jurisdictions in order to allow sufficient time for members to implement this requirement.]*

1.2.3 **Trading Partners, Directors, Officers and Compliance Officers**

(a) **Definition.** In this Rule, **"trading partner, director or officer"** means each partner, director or officer who is required to be registered and/or licensed under applicable securities legislation.

(b) **Course Requirements.** Each trading partner, director, officer and designated compliance officer of a Member shall have successfully completed any one of the following courses:

(i) the Canadian Securities Course offered by the Canadian Securities Institute;

(ii) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada; or

(iii) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers;

and, any one of the following:

(iv) the Partners', Directors' and Senior Officers' Qualifying Examination offered by the Canadian Securities Institute; or

(v) the Mutual Fund Officers', Partners' and Directors' Course offered by the Investment Funds Institute of Canada.

(c) **Registration**. Each trading partner, director, officer and compliance officer of a Member shall be registered and/or licensed in the

appropriate category under applicable securities legislation and shall comply with the requirements of such legislation in connection therewith.

*[**Note**: The MFDA is considering a transition period for trading partners, officers and directors of introducing dealers.]*

1.2.4 **Currency of Courses**. An individual shall be exempt from taking any of the courses or writing the examinations required under Rules 1.2.1(a), 1.2.2(a) or 1.2.3(b) if the individual:

(a) was registered/licensed under applicable securities legislation in the same category within three years of the relevant time for qualification; or

(b) successfully completed the course or examination within three years of the relevant time for qualification;

provided that despite subsections (a) and (b), if an individual completes a course for which another course is a prerequisite, the course which is a prerequisite need not have been completed within the three year period.

1.2.5 **Notification of Changes in Registration Information**. Every Member must notify the Corporation within five business days, and immediately in the case of the events in (f), of:

(a) any change in address for service in a province or territory in which it carries on dealer business;

(b) any change in the partners, directors or officers of the Member and, in the case of resignation, dismissal, severance or termination of employment or office, the reason therefor;

(c) every commencement and termination of an employment or agency relationship with an Approved Person and, in the case of termination by the Member, the reason therefor;

(d) the opening or closing of any branch office or sub-branch office in a province or territory in which the Member carries on dealer business and, in the case of the opening of any branch office or sub-branch office in a province or territory, the name and address of the branch manager or sub-branch manager, as the case may be;

(e) material changes in any other information previously filed by or on behalf of the Member with the Corporation, including a charge or indictment against such Member pursuant to any criminal laws or securities legislation; and

(f) the Member being declared bankrupt or making a voluntary assignment in bankruptcy or a proposal under any legislation relating to bankruptcy or insolvency, being subject to or instituting any proceedings, arrangement or compromise with creditors or having a receiver and/or manager appointed to hold its assets.

2 RULE NO. 2 - BUSINESS CONDUCT

2.1 GENERAL

2.1.1 **Standard of Conduct**. Each Member and each Approved Person of a Member shall:

(a) deal fairly, honestly and in good faith with its clients;

(b) observe high standards of ethics and conduct in the transaction of business;

(c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and

(d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation.

2.1.2 **Member Responsible**. Each Member shall be responsible for the acts and omissions of each of its Approved Persons and other employees and agents relating to its dealer business for all purposes under the By-laws and Rules.

2.1.3 **Confidential Information**

(a) All information received by a Member relating to a client or the business and affairs of a client shall be maintained in confidence by the Member and its Approved Persons and other employees and agents. No such information shall be disclosed to any other person or used for the improper advantage of the Member or its Approved Persons or other employees or agents without the prior written consent of the client or as required or authorized by legal process or statutory authority.

(b) Each Member shall develop and maintain written policies and procedures relating to confidentiality and the protection of information held by it in respect of clients.

2.1.4 **Conflicts of Interest**

(a) Each Member and Approved Person and other employee and agent of a Member shall be aware of the possibility of conflicts of interest arising in connection with business conducted by them for a client. In the event that such a

conflict or potential conflict of interest arises, the Member shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with Rules 2.1.4(b) and (c).

(b) Any conflict of interest that arises or can reasonably be expected to arise as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing by the Member to the client prior to the Member, or any person acting on its behalf in connection with its business, conducting business for the client.

(c) Each Member shall develop and maintain written policies and procedures to ensure compliance with Rules 2.1.4(a) and (b).

2.2 **NEW ACCOUNTS**

2.2.1 **"Know-Your-Client"**. Each Member shall use due diligence:

(a) to learn the essential facts relative to each client and to each order or account accepted;

(b) to ensure that the acceptance of any order for any account is within the bounds of good business practice; and

(c) to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives.

2.2.2 **New Account Application Form**. A New Account Application Form must be completed for each new account of a client. Such form shall be duly completed to conform with the requirements of Rule 2.2.1 and shall be signed by the client and dated. Account numbers must not be assigned unless they are accompanied by the proper name and address for the client and such name and address must be supported by the New Account Application Form.

2.2.3 **New Account Approval.** Each Member shall designate a partner, director or officer or, in the case of a branch office, a branch manager reporting directly to the designated partner, director or officer, who shall be responsible for approval of the opening of new accounts and the supervision of account activity. The designated person shall prior to or promptly after the completion of any initial transaction specifically approve the opening of such account in writing upon the New Account Application Form.

2.2.4 **Updating the New Account Application Form**

(a) Each New Account Application Form must be updated to include any material change in client information whenever a Member or Approved Person or other employee or agent becomes aware of such change including pursuant to Rule 2.2.4(b).

(b) Without reducing the responsibility of Members in Rule 2.2.1, all Members must ensure that a client's New Account Application Form and information referred to in Rule 2.2.1 is periodically updated at a minimum annually or when a client's circumstances are known to the Member have changed. The date upon which any such client information is recorded or amended must be retained within each client file.

(c) Written authorization must be obtained from the client for any change in a client name or address.

2.3 **POWER OF ATTORNEY/LIMITED TRADING AUTHORIZATION**

2.3.1 **Prohibition**. No Member or Approved Person shall accept or act upon a general power of attorney or other similar authorization from a client in favour of the Member or Approved Person.

2.3.2 **Limited Trading Authorization**. A Member or Approved Person may accept a limited trading authorization from a client for the express purpose of facilitating trade execution. In such circumstances a form of limited trading authorization as prescribed by the Corporation must be completed and approved by the compliance officer or branch manager, and retained in the client's file.

2.3.3 **Review**. Each trade made pursuant to a limited trading authorization must be identified as such in the books and records of the Member and on any order documentation.

2.3.4 **No Discretionary Trading**. A limited trading authorization shall not in any way confer general discretionary trading authority upon a Member, an Approved Person or any person acting on behalf of the Member.

2.4 **REMUNERATION, COMMISSIONS AND FEES**

2.4.1 **Payable by Member Only**. All remuneration in respect of dealer business conducted by an Approved Person in respect of a Member must be paid by the Member directly to and in the name of the Approved Person. No Approved Person in respect of a Member shall accept or permit any associate to accept directly or indirectly, any remuneration, gratuity, benefit or any other consideration from any person other than the Member or its affiliates or its related companies, in respect of the dealer business carried out by such Approved Person on behalf of the Member or its affiliates or its related companies.

2.4.2 **Referral Arrangements**

(a) **Definitions**. For the purpose of this Rule 2.4.2

(i) a "referral arrangement" is an arrangement whereby a Member is paid or pays a fee, including fees based on commissions or sharing a commission, for the referral of a client to or from another person; and

(ii) a referral arrangement does not include any payment to a third party service provider where the service provider has no direct contact with clients and where the services provided are wholly administrative and do not constitute dealer business.

(b) **Permitted Arrangements**. Referral arrangements may only be entered into on the following basis:

(i) the referral arrangement is only between a Member and another Member or between a Member and an entity that is (A) licensed or registered in another category pursuant to applicable securities legislation, (B) a Canadian financial institution for the purposes of National Instrument 14-101, (C) insurance agents or brokers, or (D) subject to such other regulatory system as may be prescribed by the Corporation;

(ii) there is a written agreement governing the referral arrangement prior to implementation;

(iii) all fees or other form of compensation paid as part of the referral arrangement, to or by the Member, must be recorded on the books and records of the Member; and

(iv) written disclosure of referral arrangements must be made to clients prior to any transactions taking place. The disclosure document must include an explanation of how the referral fee is calculated such that the amount owing on account of such referral fee is determinable by such clients, the name of the parties receiving and paying the fee, and a statement that it is illegal for the party receiving the fee to trade or advise in respect of securities if it is not duly licensed or registered under applicable securities legislation to provide such advice.

2.4.3 **Service Fees or Charges.** No Member shall impose on any client or deduct from the account of any client any service fee or service charge relating to services provided by the Member in connection with the client's account unless written notice shall have been given to the client on the opening of the account or not less than 60 days prior to the imposition or revision of the fee or charge. For the purposes of this Rule, service fees or charges shall not include any commissions charged for executing trades.

2.5 **MINIMUM STANDARDS OF SUPERVISION**

2.5.1 **Member Responsibilities.** Each Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of dealer business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation.

2.5.2 **Compliance Officer**

(a) **Designation**. Each Member must designate a trading officer as a "compliance officer" who shall be or report to any one of the Member's chief executive officer, chief operating officer or chief financial officer.

(b) **Responsibilities**. The compliance officer shall be responsible for monitoring adherence by the Member and any person conducting dealer business on account of the Member to the By-laws, Rules and Policies, including, without limitation, standards of business conduct under Rule 2 and applicable securities legislation requirements. The compliance officer or the individual to whom the compliance officer reports is required to report on the status of compliance at the Member to the board of directors or partners of the Member as necessary, and at least on an annual basis. It shall be the responsibility of the board of directors or partners of the Member to act on the annual report and to rectify any compliance deficiencies noted in the report.

(c) **Alternates**. In the event that a compliance officer is absent or unable to perform his or her responsibilities, a Member shall designate one or more alternates who must be qualified as compliance officers pursuant to Rule 1.2.3 and who shall carry out the responsibilities of the compliance officer.

2.5.3 **Branch Manager**

(a) **Designation**. Each Member shall designate a person qualified as a branch manager pursuant to Rule 1.2.2 for each branch office (as defined in By-law 1.1) of the Member. The Member is not required to designate a branch manager for a sub-branch office who is normally present at the office, provided that a branch manager who is not normally present at such sub-branch office, or a trading partner, director or officer or a compliance officer

designated as the branch manager for such sub-branch office, supervises the dealer business at the sub-branch office in accordance with the By-laws and Rules.

(b) **Responsibilities**. It is the responsibility of a branch manager to:

(i) ensure that the dealer business conducted on behalf of the Member by an Approved Person and other employees and agents at the branch is in compliance with applicable securities legislation and the By-laws and Rules;

(ii) supervise the opening of new accounts and trading activity at the branch office.

(c) **Alternates (Assistant or Co-Branch Managers)**. In the event that a branch manager is absent or unable to perform his or her responsibilities, a Member shall designate one or more assistant or co-branch managers who must be qualified as branch managers pursuant to Rule 1.2.2 and who shall carry out the responsibilities of the branch manager.

2.5.4 **Maintenance of Supervisory Review Documentation.** The Member must maintain records of all compliance and supervisory activities undertaken by it and its partners, directors, officers, compliance officers and branch managers pursuant to the By-laws and Rules.

2.5.5 **No Delegation**. No Member or director, officer, partner, compliance officer, branch manager or assistant or co-branch manager shall be permitted to delegate any supervision or compliance responsibility under the By-laws or Rules in respect of any dealer business of the Member, except as expressly permitted pursuant to the By-laws and Rules.

2.6 **LEVERAGED SECURITIES PURCHASES**

Each Member shall provide to each client a risk disclosure document in the form prescribed by the Corporation when (a) a new account is opened for the client and (b) when an Approved Person makes a recommendation for purchasing securities by leveraging, or otherwise becomes aware of a client's intent to employ leveraged monies for the purpose of investment, provided that a Member is not required to comply with paragraph (b) if such a risk disclosure document has been provided to the client by the Member within the six month period prior to such recommendation.

2.7 **ADVERTISING AND SALES COMMUNICATIONS**

2.7.1 **Definitions.** For the purposes of the By-laws and Rules:

(a) "advertisement" includes television or radio commercials or commentaries, billboards, internet websites, newspapers and magazine advertisements or commentaries and any published material promoting the business of a Member and any other sales literature disseminated through the communications media; and

(b) "sales communication" includes records, video tapes and similar material, market letters, research reports, and all other published material, except preliminary prospectuses and prospectuses, designed for or use in presentation to a client or a prospective client whether such material is given or shown to them and which includes a recommendation in respect of a security.

2.7.2 **General Restrictions**. No Member shall issue to the public, participate in or knowingly allow its name to be used in respect of any advertisement or sales communication in connection with its business which:

(a) contains any untrue statement or omission of a material fact or is otherwise false or misleading, including the use of a visual image such as a photograph, sketch, drawing, logo or graph which conveys a misleading impression;

(b) contains an unjustified promise of specific results;

(c) uses unrepresentative statistics to suggest unwarranted or exaggerated conclusions, or fails to identify the material assumptions made in arriving at these conclusions;

(d) contains any opinion or forecast of future events which is not clearly labelled as such;

(e) fails to fairly present the potential risks to the client;

(f) is detrimental to the interests of the public, the Corporation or its Members; or

(g) does not comply with any applicable legislation or the guidelines, policies or directives of any regulatory authority having jurisdiction over the Member.

2.7.3 **Review Requirements.** No advertisement or sales communication shall be issued unless first approved by a partner, director, officer, compliance officer or branch manager who has been designated by the Member as being responsible for advertisements and sales communications.

2.8 **CLIENT COMMUNICATIONS**

2.8.1 **Definition.** For the purposes of the By-laws and Rules "client communication" means any written communication by a Member to a client of the Member including trade confirmations and account statements.

2.8.2 **General Restrictions.** No client communication shall:

(a) be untrue or misleading or use an image such as a photograph, sketch, logo or graph which conveys a misleading impression;

(b) make unwarranted or exaggerated claims or conclusions or fail to identify the material assumptions made in arriving at these conclusions;

(c) be detrimental to the interests of clients, the public, the Corporation or its Members; or

(d) contravene any applicable legislation or any guideline, policy, rule or directive of any regulatory authority having jurisdiction over the Member.

2.8.3 **Rates of Return.** In addition to complying with the requirements in Rule 2.8.2, any client communication containing or referring to a rate of return regarding a specific account or group of accounts must explain in writing to the client the methodology used to calculate such rate of return in sufficient detail and clarity to reasonably permit the client to understand the basis of the rate of return.

2.9 **INTERNAL CONTROLS**. Every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time.

2.10 **POLICIES AND PROCEDURES MANUAL**. Every Member shall establish and maintain written policies and procedures (that have been approved by senior management of the Member) for dealing with clients and ensuring compliance with the Rules, By-laws and Policies of the Corporation and applicable securities legislation.

2.11 **COMPLAINTS**. Every Member shall maintain a log of client complaints and shall establish written policies and procedures for dealing with client complaints which ensure that such complaints are dealt with promptly and fairly.

2.12 **TRANSFERS OF ACCOUNT**

2.12.1 **Definitions.** For the purposes of the By-laws and Rules:

(a) "account transfer" means the transfer in its entirety of an account of a client with a Member to another Member at the request or with the authority of the client;

(b) "delivering Member" means in respect of an account transfer the Member from which the account of the client is to be transferred; and

(c) "receiving Member" means in respect of an account transfer the Member to which the account of the client is to be transferred.

2.12.2 **Notification**

(a) When a client informs a receiving Member of his or her intent to transfer his or her account(s) to the receiving Member, the receiving Member must obtain an Authorization to Transfer Account letter in a form prescribed by the Corporation from the client and provide it to the delivering Member within five business days.

(b) When a Member is notified by an Approved Person that the Approved Person is to become approved in respect to another Member, the Delivering Member must deliver to its clients who conduct business with the Approved Person within five business days of receipt of such notification:

(i) notice of the Approved Person's transfer,

(ii) an explanation of the clients' option to either remain clients of the delivering Member or transfer their accounts to the receiving Member and instructions on how to have the account transferred, and

(iii) an Authorization to Transfer Account letter in a form prescribed by the Corporation.

2.12.3 **Response to Notification.**

(a) A delivering Member that receives a completed Authorization to Transfer Account letter must within 10 business days of receipt:

(i) if Rule 2.12.2(b) applies, inform the receiving Member of the client's intent to transfer,

(ii) inform the receiving Member whether the client's securities are held in a nominee name account or a client name account, and

(iii) request notification from the receiving Member as to whether the securities will be held in a nominee name account or client name account upon transfer.

(b) If both the delivering and receiving Members operate nominee name accounts, the delivering Member must provide any relevant mutual fund companies with a Dealer to Dealer transfer form and power of attorney.

(c) If both the delivering and receiving Members operate client name accounts, the delivering Member will immediately advise any relevant mutual fund companies to change the dealer code upon receipt of the client's Authorization to Transfer Account letter.

(d) If the delivering Member operates a client name account and the receiving Member operates a nominee name account or the delivering Member operates a nominee name account and the receiving Member operates a client name account, the receiving Member must obtain written authorization from the client to change the registered owner name from the client name or the delivering Member name, as the case may be, and forward such completed authorization to the relevant mutual fund companies.

(e) If the delivering Member operates a nominee name account and the receiving Member operates a client name account, the delivering Member shall provide to the relevant mutual fund companies an authorization to change the registered owner name to the name of the transferring client immediately upon receipt of the receiving Member's instructions to do so.

2.12.4 **Completion.**

(a) The transfer of a client account is complete when:

(i) the dealer codes have been changed where both Members operate client name accounts;

(ii) the delivering Member provides the receiving Member with a Dealer to Dealer transfer form and power of attorney where both Members operate nominee name accounts; or

(iii) the registered owner has been changed where the delivering Member operates in a different manner than the receiving Member.

(b) For the purposes of compliance with the Rules and By-laws, a client remains the responsibility of the delivering Member until the transfer is complete.

(c) A receiving Member must complete a "New Account Application Form" for each client that has transferred.

(d) The receiving Member shall ensure that such forms or documents as may be required in order to transfer trusteed accounts or other accounts which cannot be transferred without such forms or documents are duly completed and provided to the delivering Member.

(e) The delivering Member must within 15 days of an account transfer being completed, as described in Rule 2.12.4(a), provide notification of completion of transfer to the receiving Member.

3 RULE NO. 3 - FINANCIAL AND OPERATIONS REQUIREMENTS

3.1 CAPITAL

3.1.1 **Minimum Levels**. Each Member shall have and maintain at all times risk adjusted capital greater than zero, and minimum capital in the amounts referred to below for the Level in which the Member is designated, as calculated in accordance with Form 1 and with such requirements as the Corporation may from time to time prescribe:

Level 1 $25,000 for a Member which is a Type 1 introducing dealer and which satisfies the requirements of Rule 1.1.6(a) and (b).

Level 2 $75,000 for a Member which:

(a) does not hold client cash, securities or other property; and

(b) does not act as an agent of a trustee in administering the accounts of client self-directed plans which are registered for taxation purposes.

Level 3 $125,000 for a Member which:

(a) does not hold client securities or other property, except client cash in a trust account; and

(b) does not act as an agent of a trustee in administering the accounts of client self-directed plans which are registered for taxation purposes.

Level 4 $200,000, for any other Member, including a Member which acts as a carrying dealer in accordance with Rule 1.1.6.

3.1.2 **Notice**. If at any time the risk adjusted capital of a Member is, to the knowledge of the Member, less than zero, the Member shall immediately notify the Corporation.

*[**Note**: The MFDA is proposing a transition period in order to provide members sufficient time to accumulate the required minimum capital levels. See section 10.1 of the "Description of the Structure and Self-Regulating Activities of the MFDA" for further information about the proposed time periods and minimum capital levels. Such transition periods will not alleviate members from having to comply with capital requirements under the applicable securities legislation in the relevant jurisdiction.]*

3.2 CAPITAL AND MARGIN

3.2.1 **Client Lending and Margin**. No Member shall lend or extend credit to a client or permit the purchase of securities by a client on margin, except as provided for in Rule 3.2.3.

3.2.2 **Member Capital**. Each Member shall maintain capital in respect of its firm business in accordance with the requirements set out in Form 1.

3.2.3 **Advancing Mutual Fund Redemption Proceeds**. No Member shall advance funds or extend credit to or on behalf of a client, directly or indirectly, in connection with the receipt of funds on the redemption of mutual fund securities unless:

(a) the Member has received prior written confirmation of the redemption order from the issuer of the securities;

(b) the redemption proceeds to be received (excluding any fees or commissions) are equal to or greater than the amount of funds or credit to be provided;

(c) the client has authorized and directed the issuer of the securities to be redeemed to pay the redemption proceeds to, or to the direction of, the Member;

(d) the Member maintains a copy of the confirmation of the redemption order and the client's authorization; and

(e) the Member is designated as being in Level 2, 3 or 4 for the purposes of Rule 3.1.1.

3.2.4 **Related Company Guarantees**

(a) Each Member shall be responsible for and shall guarantee the obligations to clients incurred by each of its related companies (as defined in By-law 1), and each related company shall be responsible for and shall guarantee the obligations of the Member to its clients on the following basis:

(i) where a Member holds an ownership interest in a related company, the Member shall provide a guarantee in an amount equal to 100% of the Member's capital employed (as determined in accordance with Form 1);

(ii) where a Member holds an ownership interest in a related company, the related company shall provide a guarantee of the Member in an amount equal to the percentage of the related company's capital employed that corresponds to the percentage of ownership interest the Member holds in the related company; and

(iii) where two related companies are related because of a common ownership interest held by the same person(s), each related company shall provide a guarantee of the other in an amount equal to the percentage of its capital employed that corresponds to the percentage ownership interest held by the person(s) who holds the common ownership interest.

(b) A guarantee shall not be required at all or in the amount prescribed in accordance with Rule 3.2.4(a) where the Corporation in its discretion determines that a guarantee is not appropriate.

(c) A guarantee shall be required in such greater or lesser amount as prescribed in Rule 3.2.4(a) where the Corporation in its discretion determines that such greater or lesser guarantee amount is appropriate.

(d) A guarantee required pursuant to this Rule 3.2.4 shall be in the form prescribed from time to time by the Corporation.

3.3 **SEGREGATION OF CLIENT PROPERTY**

3.3.1 **General**. Each Member that holds cash, securities or other property of its clients shall hold such cash, securities or property separate and apart from its own property and in trust for its clients in accordance with this Rule 3.3.

3.3.2 **Cash**

(a) **Trust Account**. All cash held by a Member on behalf of clients shall be held separate and apart from the property of the Member in a designated trust account with a financial institution (which is an acceptable institution for the purposes of Form 1).

(b) **Determination**. Each Member shall determine on a daily basis the amount of cash it holds for clients and that is required to be held in segregation pursuant to this Rule 3.3.

(c) **Deficiency**. In the event of a deficiency in the amount of cash required to be held in trust for a client, the Member shall immediately provide from its own funds an amount necessary to correct the deficiency and any unsatisfied obligation to do so shall be immediately charged to the capital of the Member.

(d) **Notice to Institution**. The Member must advise the financial institution in writing that:

(i) the account is established for the purpose of holding client funds in trust and the account shall be designated as a "trust account";

(ii) money may not be withdrawn, including by way of electronic transfer, by any person other than authorized employees of the Member; and

(iii) the money held in trust may not be used to cover shortfalls in any other accounts of the Member.

(e) **Commingling**. The Member shall not commingle money for mutual fund transactions with money held in trust for the purchase or sale of other securities or financial products (such as deposit instruments or segregated funds). The Member must maintain separate accounts, which may be designated as trust accounts, for the purchase and sale of such other securities or financial products.

(f) **Interest Bearing**. Trust accounts must be established to earn a market rate of interest.

(g) **Use of Funds**. The Member shall not use any money received for the investment of mutual funds or other securities to finance its own operations.

(h) **Distributions**. The Member must have a system in place to properly distribute on a cash basis interest earned in the mutual fund trust account to either the mutual fund companies for reinvestment or to clients directly.

3.3.3 **Securities**

(a) **Internal Locations**. For the purposes of Rule 3.3.1, a Member may hold securities or other investment products within the physical possession or control of the Member segregated and held in trust for clients of the Member, provided that all internal storage locations are designated in the Member's ledger of accounts and the Member has adequate internal accounting controls and systems for safeguarding of securities held for clients.

(b) **External Locations**. For the purposes of Rule 3.3.1, securities or other investment products held beyond the physical possession of the Member must be segregated and held in trust for clients of a Member, or segregated and held by or for a Member, as the case may be, in acceptable securities locations, provided that the written terms upon which such securities or other investment products are deposited and held beyond the physical possession of the Member include provisions to the effect that:

(i) no use or disposition of the securities or products shall be made without the prior written consent of the Member;

(ii) certificates representing the securities or products can be delivered to the Member promptly on demand or, where certificates are not available and the securities are represented by book entry at the location, the securities or products can be transferred either from the location or to another person at the location promptly on demand; and

(iii) the securities or products are held in segregation for the Member or its clients free and clear of any charge, lien, claim or encumbrance of any kind in favour of the depository or institution holding such securities or products.

(c) **Bulk Segregation.** A Member, which holds securities or property of clients in segregation in accordance with Rule 3.3.1 may hold securities or property in bulk segregation provided that the Member identifies in its records the amount and kind of each security or property held for each client. The Member shall determine, for all accounts of each client the market value and number of all securities to be held for the client.

(d) **General Restrictions**. In complying with its obligation to segregate client securities in accordance with Rule 3.3.1, each Member shall ensure that:

(i) a segregation deficiency is not knowingly created or increased; and

(ii) all securities of clients received by the Member are segregated.

(e) **Correction of Segregation Deficiencies**. In the event that a segregation deficiency exists, the Member shall expeditiously take the most appropriate action required to settle the segregation deficiency. If for any reason the deficiency has not been settled within 30 days of being discovered, the Member shall immediately purchase the securities or property for the account of the client.

3.4 **EARLY WARNING**

3.4.1 (a) **Levels**. A Member shall be designated in early warning level 1 or level 2 according to its capital, profitability and liquidity position from time to time and frequency of designation or at the discretion of Corporation as provided in this Rule 3.4.

(b) **Definitions**. The terms and definitions used in this Rule 3.4 shall have the same meanings as used in Form 1, unless otherwise defined in the By-laws or Rules or the context requires.

3.4.2 **Level 1**

(a) **Designation**. A Member shall be designated in early warning level 1 if at any time:

Liquidity
Its early warning reserve is a negative number; or

Capital
Its risk adjusted capital is less than 5% of total margin required; or

Profitability
The risk adjusted capital at the time of calculation is less than six times the net loss (before interest on internal subordinated debt, bonuses, income taxes and extraordinary items) for the current month.

Discretionary
The condition of the Member, in the sole discretion of the Corporation, is not satisfactory for any reason including, without limitation, financial or operating difficulties, problems arising from record keeping conversion or significant changes in clearing methods, the fact that the Member is a new Member or the Member has been late in any filing or reporting required pursuant to the By-laws and Rules.

(b) **Requirements**. If a Member is designated in early warning level 1 then, notwithstanding the provisions of any By-law or Rule (other than Rule 3.4.3(b)), the following provisions shall apply:

(i) the chief executive officer and chief financial officer of the Member shall immediately deliver to the Corporation a letter containing the following:

(A) advice of the fact that any of the circumstances in Rule 3.4.2 are applicable,

(B) an outline of the problems associated with the circumstances referred to in (A),

(C) an outline of the proposal of the Member to rectify the problems identified, and

(D) an acknowledgement that the Member is in early warning category and that the restrictions contained in Rule 3.4.2(b)(iv) apply,

a copy of which letter shall be provided to the Member's auditor;

(ii) the Corporation shall immediately designate the Member as being in an early warning category level 1 and shall deliver to the chief executive officer and chief financial officer a letter containing the following:

(C) advice that the Member is designated as being in early warning category level 1,

(B) a request that the Member file its next monthly financial report required pursuant to Rule 3.5.1(a) no later than 15 business days or, in the discretion of the Corporation if

considered to be practicable, such earlier time following the end of the relevant month,

(C) a request that the Member respond to the letter as required under Rule 3.4.2(b)(iii) and confirmation that such response, together with the notice received pursuant to Rule 3.4.2(b)(i), will be forwarded to MFDA Investor Protection Fund and may be forwarded to any securities commission having jurisdiction over the Member,

(D) advice that the restrictions referred to in Rule 3.4.2(b)(iv) shall apply to the Member,

(E) such other information as the Corporation shall consider relevant;

(iii) the chief executive officer and the chief financial officer of the Member shall respond by letter signed by them both within five business days of receipt of the letter referred to in Rule 3.4.2(b)(ii), with a copy to be sent to the auditor of the Member, containing the information and acknowledgement required pursuant to Rule 3.4.2(b)(i)(B), (C) and (D), to the extent not previously provided, or an update of such information if any material circumstances or facts have changed;

(iv) if and so long as the Member remains designated as being in an early warning category, it shall not without the prior written consent of the Corporation:

(A) reduce its capital in any manner including by redemption, re-purchase or cancellation of any of its shares,

(B) reduce or repay any indebtedness which has been subordinated with the approval of the Corporation,

(C) directly or indirectly make any payments by way of loan, advance, bonus, dividend, repayment of capital or other distribution of assets to any director, officer, partner, shareholder, related company, affiliate or associate,

(D) increase its non-allowable assets (as specified by the Corporation) unless a prior binding commitment to do so exists or enter into any new commitments which would have the effect of materially increasing the non-allowable assets of the Member,

(v) if and so long as the Member remains designated as being in an early warning category it shall continue to file its monthly financial reports within the time specified pursuant to Rule 3.4.2(b)(ii)(B), or

(vi) as soon as practicable after the Member is designated as being in an early warning category, the Corporation shall conduct an on-site review of the Member's procedures for monitoring capital on a daily basis and prepare a report as to the results of the review.

No Member shall enter into any transaction or take any action, as described in any of Rule 3.4.2(b)(iv)(A), (B), (C) or (D), which, when completed, would have or would reasonably be expected to have the effect on the Member as described in any of Rule 3.4.2(a), without first notifying the Corporation in writing of its intention to do so and receiving the written approval of the Corporation prior to implementing such transaction or action.

3.4.3 **Level 2**

(a) **Designation**. A Member shall be designated in early warning level 2 if at any time:

Liquidity
Its early warning excess is a negative number; or

Capital
Its risk adjusted capital is less than 2% of total margin required; or

Profitability
(i) The risk adjusted capital at the date of calculation is less than three times the net loss (before interest on internal subordinated debt, bonuses, income taxes and extraordinary items) for the current month; or

(ii) the risk adjusted capital at the time of calculation is less than the total net profit or loss (as defined above) for the three months ending with the current month.

Frequency
(i) It has been designated in an early warning level (any combination of levels 1 and 2) three or more times in the preceding six months; or

(ii) It has been designated in early warning level 1 under the Profitability criteria and at the time

has been designated in early warning level 1 under either the Liquidity or Capital criteria.

(b) **Requirements**. If the Member is designated as being in early warning level 2, the following provisions shall apply in addition to the provisions of Rule 3.4.2 which shall continue to apply except to the extent inconsistent with this Rule 3.4.3(b):

(i) the chief executive officer and the chief financial officer of the Member shall immediately deliver to the Corporation a letter advising that the circumstances of this Rule 3.4.3(b) are applicable to the Member;

(ii) the Member shall file its monthly financial reports required pursuant to Rule 3.5.1(a) no later than 10 business days or, in the discretion of the Corporation if considered to be practicable, such earlier time following the end of the relevant month;

(iii) the chief executive officer and the chief financial officer of the Member shall attend at the offices of the Corporation to outline the proposals of the Member for rectifying the problems which account for the Member being designated as being in early warning category Level 2;

(iv) the Member shall file a weekly capital report containing the same information required in a monthly financial report pursuant to Rule 3.5.1(a) no later than five business days or, in the discretion of the Corporation if it considers it to be practicable, such earlier time following the end of the relevant week;

(v) the Member shall file weekly on a form prescribed by the Corporation a report of its aged segregation deficiencies and an explanation of the actions proposed to be taken pursuant to Rule 3.3.3(e) to correct such deficiencies;

(vi) the Member shall prepare and file a business plan relating to the Member's business within such time, for such period and covering such matters as the Corporation may direct;

(vii) the Corporation may request and the Member shall provide in such time as the Corporation considers practicable, such reports or information, on a daily or a less frequent basis, as may be necessary or desirable in the opinion of the Corporation to assess and monitor the financial condition or operations of the Member; and

(viii) the Member shall pay, at the discretion of the Corporation, the reasonable costs and expenses of the Corporation incurred in connection with the administration of this Rule 3.4 in respect of the Member.

3.4.4 **Restrictions**. The Corporation may in its discretion, without affording the Member a hearing, prohibit a Member which is designated as being in the early warning category level 2 from opening any new branch offices, hiring any new Approved Persons, opening any new client accounts or changing in any material respect the inventory positions of the Member. Any such prohibitions which have been imposed shall continue to apply until the Member is no longer designated as being in an early warning category level 1 or level 2, as demonstrated by the latest filed monthly financial report of the Member.

3.4.5 **Duration**. A Member shall remain designated as being in early warning level 1 or level 2, as the case may be, and subject to the provisions in this Rule 3.4 as are applicable, until the latest filed monthly financial reports of the Member demonstrate, in the opinion of the Corporation that the Member no longer is required to be designated as being in an early warning category and the Member has otherwise complied with this Rule 3.4.

3.5 **FILING REQUIREMENTS**

3.5.1 **Monthly and Annual**. Each Member shall:

(a) file monthly with the Corporation within 20 days of the month's end a copy of a financial report of the Member as at the end of each fiscal month. Such monthly financial reports shall contain or be accompanied by such information as may be prescribed by the Corporation from time to time; and

*[**Note**: A transition period will be provided allowing Members to file quarterly for the first two years after the MFDA is recognized as an SRO. It is expected that such filings will comprise the information in Statements A, B, C and D, and Schedule 1, of Form 1, together with the partner's or director's certificate in Form 1. The quarterly filings are expected to be made through an electronic e-mail system.]*

(b) file annually with the Corporation two copies of the audited financial statements of the Member as at the end of the Member's fiscal year or as at such other fixed date as may be agreed with the Corporation. Such statements shall be in such form, shall contain such information and shall be supplemented by such additional schedules as the Corporation may from time to time prescribe, and shall be filed through the Member's auditor within seven weeks of the date as of which such statements are required to be prepared;

3.5.2 **Consolidated Statements**. In calculating the risk adjusted capital of a Member, the financial position of the Member may, with the prior approval of the Corporation, be consolidated (in a manner as set out below) with that of any related company provided that:

(a) the Member has guaranteed the obligations of such related company and the related company has guaranteed the obligations of the Member (such guarantee to be in a form acceptable to the Corporation and unlimited in amount).

(b) inter-company accounts between the Member and the related company shall be eliminated;

(c) any minority interests in the related company shall be eliminated from the capital calculation; and

(d) calculations with respect to the Member and the related company shall be as of the same date.

3.5.3 **Related Companies**. In addition to the statements under Rule 3.5.1, each Member shall file annually with the Corporation through the Member's auditor, particulars of the name and relationship to the Member of each related company of the Member and such financial statements and reports with respect to the affairs of any such related company of the Member as the Corporation considers necessary or advisable.

3.5.4 **Members' Auditors**

(a) Every Member's auditor shall examine the accounts of the Member as at the date referred to in Rule 3.5.1 and shall make a report thereon in such form as the Corporation may from time to time prescribe. Each Member's auditor shall also make such additional examinations and reports as the Corporation may from time to time request or direct.

(b) The Member's auditor shall conduct his or her examination of the accounts of the Member in accordance with generally accepted auditing standards and the scope of his or her procedures shall be sufficiently extensive to permit him or her to express an opinion on the Member's financial statements in the form prescribed. Without limiting the generality of the foregoing, the scope of the examination shall, where applicable, include at least the procedures set out in Rule 3.6.

(c) Every Member's auditor for the purpose of any such examination shall be entitled to free access to all books of account, securities, cash, documents, bank accounts, vouchers, correspondence and records of every description of the Member being examined or its affiliates or its related companies, and no Member, affiliate or related company, as the case may be, shall withhold, destroy or conceal any information, document or thing reasonably required by the Member's auditor for the purpose of such examination.

3.5.5 **Assessments**

(a) **Excessive Attention**. If at any time the Corporation is of the opinion that the financial condition or conduct of the business of any Member has required excessive attention from the Corporation and that it would be in the interests of the Corporation that the Corporation be reimbursed by such Member, the Corporation shall have the power to impose an assessment against such Member.

(b) **Late Filing**. Each Member shall be liable for and pay to the Corporation levies or assessments in the amounts prescribed from time to time by the Corporation for the failure of the Member, its auditors or any person acting on its behalf, to file any report, form, financial statement or other information required under this Rule 3 within the times prescribed by this Rule 3, the Corporation or the terms of such report, form, financial statement or other information, as the case may be.

3.6 **AUDIT REQUIREMENTS**

3.6.1 **Standards**. The audit under Rule 3.5 shall be conducted in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding assets. It shall include all audit procedures necessary under the circumstances to support the opinions which must be expressed in the Member's auditor's reports of Parts I and II of Form 1. Because of the nature of the industry, the substantive audit procedures relating to the financial position must be carried out as of the audit date and not as of an earlier date, notwithstanding that the audit is otherwise conducted in accordance with generally accepted auditing standards.

3.6.2 **Scope**. The scope of the audit shall include the following procedures, but nothing herein shall be construed as limiting the audit or permitting the omission of any additional audit procedure which any Member's auditor would deem necessary under the circumstances. For purposes of this Rule tests fall into two basic categories (as described in CICA Handbook section 5300.11 to 5300.21):

(a) specific item tests, whereby the auditor examines individual items which he or she considers should be examined because of their size, nature or method of recording (CICA Handbook Section 5300.13); and

(b) representative item tests, whereby the auditor's objective is to examine an unbiased selection of items (Section 5300.13).

The determination of an appropriate sample on a representative basis may be made using either statistical or non-statistical methods (CICA Handbook Section 5300.14).

In determining the extent of the tests appropriate in sub-sections (i), (ii) and (iii) of (c) below, the Member's auditor should consider the adequacy of the system of internal control and the level of materiality appropriate in the circumstances so that in the auditor's professional judgement the risk of not detecting a material misstatement, whether individually or in aggregate is reduced to an appropriately low level (e.g. in relation to the estimated risk adjusted capital and early warning reserves).

The Member's auditor shall:

(c) as of the audit date:

(i) compare ledger accounts with the trial balances obtained from the general and subsidiary ledgers and prove the subsidiary ledger totals with their respective control accounts (see Rule 3.6.4 below relating to Electronic Data Processing);

(ii) account for, by physical examination and comparison with the books and records, all securities in the physical possession of the Member;

(iii) review the reconciliation of all mutual funds where a Member operates a nominee name account and review the balancing of all security positions. Where a position or account is not in balance according to the records, ascertain that an adequate provision has been made in accordance with the Notes and Instructions for out of balance positions embodied in Statement B of Form 1 for any potential loss;

(iv) review bank reconciliations. After allowing at least ten business days to elapse, obtain bank statements, cancelled cheques and all other debit and credit memos directly from the banks and by appropriate audit procedures substantiate on a test basis the reconciliations with the ledger control accounts as of the audit date;

(v) where a Member operates a nominee name account, ensure that all custodial agreements are in place for securities lodged with acceptable locations;

(vi) obtain written confirmation with respect to the following:

(A) bank balances and other deposits;

(B) cash, security positions and deposits with clearing houses and like organizations and cash and security positions with mutual fund companies;

(C) cash and securities loaned or borrowed (including subordinated loans) together with details of collateral received or pledged, if any;

(D) accounts with brokers or dealers;

(E) accounts of directors, partners or officers of the Member held by the Member where the Member operates a nominee name account;

(F) accounts of clients where a Member operates a nominee name account;

(G) statements from the Member's lawyers as to the status of lawsuits and other legal matters pending which, if possible, should include an estimate of the extent of the liabilities so disclosed; and

(H) all other accounts which in the opinion of the Member's Auditor should be confirmed.

Compliance with the confirmation requirements shall be deemed to have been made if positive requests for confirmation have been mailed by the Member's auditor in an envelope bearing the auditor's return address and second requests are similarly mailed to those not replying to the initial request. Appropriate alternative verification procedures must be used where replies to second requests have not been received. For accounts mentioned in (D) and (E) above, the Member's auditor shall (1) select specific accounts for positive confirmation based on (x) their size (all accounts with equity exceeding a certain monetary amount, with such amount being related to the level of materiality) and (y) other characteristics such as accounts in dispute and nominee name accounts, and (2) select a representative sample from all other accounts of sufficient extent to provide

reasonable assurance that a material error, if it exists, will be detected. For accounts in (D) and (E) above that are not confirmed positively, the Member's auditor shall mail statements with a request that any differences be reported directly to the auditor. Clients' accounts without any balance whatsoever and those closed since the last audit date shall also be confirmed on a test basis using either positive or negative confirmation procedures, the extent to be governed by the adequacy of the system of internal control;

(vii) subject the Statements in Part I and Schedules in Part II of Form 1 to audit tests and/or other auditing procedures to determine that the margin and capital requirements, which are used in the determination of the excess (deficiency) of risk adjusted capital are calculated in accordance with the Rules and Form 1 in all material respects in relation to the financial statements taken as a whole;

(viii) obtain a letter of representation from the senior officers of the Member with respect to the fairness of the financial statements including among other things the existence of contingent assets, liabilities and commitments.

(d) complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Segregation of Securities in Form 1.

3.6.3 **Insurance and Subsequent Events**. In addition, the Member's auditor shall:

(a) complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Insurance in Form 1; and

(b) report on any subsequent events, to date of filing, which have had a material adverse effect on the excess (deficiency) of risk adjusted capital.

3.6.4 **Systems Review**. The Member's auditors' review of the accounting system, the internal accounting control and procedures for safeguarding securities prescribed in the above Audit Requirements should encompass any in-house or service bureau EDP operations. (This may include reliance on CICA Handbook Section 5900 report "Opinions on Control Procedures at a Service Organization"). As a result of such review and evaluation the Member's auditor may be able to reduce the extent of detailed checking of clients and other account statements to trial balances and security position records.

3.6.5 **Retention**. Copies of Form 1 and all audit working papers shall be retained by the Member's auditor for six years. The two most recent years shall be kept in a readily accessible location. All working papers shall be made available for review by the Corporation and the MFDA Investor Protection Fund and the Member shall direct its auditor to provide such access on request.

3.6.6 **Reports to Corporation**. If the Member's auditor observes during the regular conduct of his or her audit any material breach of the By-laws or Rules pertaining to the calculation of the Member's financial position, handling and custody of securities and maintenance of adequate records he or she shall make a report to the Corporation.

3.6.7 **Reliance**. The reports and audit opinions required in respect of a Member under this Rule 3.6 shall be addressed to the Corporation and the MFDA Investor Protection Fund in conjunction with the Member who shall be entitled to rely on them for all purposes.

3.6.8 **Experience**. The reports and audit opinions referred to in this Rule 3.6 shall be signed by an engagement partner on behalf of the Member's auditor who shall have a minimum of five years audit experience in connection with mutual fund dealers, securities dealers or financial institutions.

4 RULE NO. 4 - INSURANCE

4.1 **FINANCIAL INSTITUTION BOND**. Every Member shall, by means of a Financial Institution Bond or Bonds (with Discovery Rider attached or Discovery Provisions incorporated in the Bond) and/or mail insurance, effect and keep in force insurance against losses arising as follows:

4.1.1 **Clause (A) - Fidelity** - Any loss through any dishonest or fraudulent act of any of its employees or agents, committed anywhere and whether committed alone or in collusion with others, including loss of property through any such act of any of the employees;

4.1.2 **Clause (B) - On Premises** - Any loss of cash and securities or other property through robbery, burglary, theft, hold-up or other fraudulent means, mysterious disappearance, damage or destruction while within any of the insured's offices, the offices of any banking institution or clearing house or within any recognized place of safe-deposit, as more fully defined in the Standard Form of Financial Institution Bond (herein referred to as the "Standard Form");

4.1.3 **Clause (C) - In Transit and Mail** - Any loss of cash and securities or other property through robbery, burglary, theft, hold-up, misplacement, mysterious disappearance, damage or destruction, while in transit or in the mail;

4.1.4 **Clause (D) - Forgery or Alterations** - Any loss through forgery or alteration of any cheques, drafts,

promissory notes or other written orders or directions to pay sums in cash, excluding securities, as more fully defined in the Standard Form;

4.1.5 **Clause (E) - Securities** - Any loss through having purchased or acquired, sold or delivered, or acted upon securities or other written instruments which prove to have been forged, counterfeited, raised or altered, or lost or stolen, or through having guaranteed in writing or witnessed any signatures upon any transfers, assignments or other documents or written instruments, as more fully defined in the Standard Form.

4.2 **NOTICE OF TERMINATION**. Each Financial Institution Bond maintained by a Member shall contain a rider requiring:

4.2.1 the underwriter to notify the Corporation at least 30 days prior to the termination or cancellation of the Bond, except in the event of termination of the Bond due to:

(a) the expiration of the Bond period specified;

(b) cancellation of the Bond as a result of the receipt of written notice from the insured of its desire to cancel the Bond;

(c) upon the taking over of the insured by a receiver or other liquidator, or by provincial, federal or state officials; or

(d) upon taking over of the insured by another institution or entity.

4.2.2 In the event of termination of the Bond as an entirety, the underwriter shall, upon becoming aware of such termination, give immediate written notice of the termination to the Corporation. Such notice shall not impair or delay the effectiveness of the termination.

4.3 **TERMINATION OR CANCELLATION**. In the event of the take-over of a Member by another institution or entity as described in Rule 4.2.1(d) the Member shall ensure that there is bond coverage which provides a period of twelve months from the date of such take-over within which to discover the losses, if any, sustained by the Member prior to the effective date of such take-over and the Member shall pay, or cause to be paid, any applicable additional premium.

4.4 **AMOUNTS REQUIRED**. The minimum amount of insurance to be maintained for each Clause under Rule 4.1 shall be the greater of:

4.4.1 $500,000, or, in the case of a Member designated as Level 1 or 2 for the purposes of Rule 3.1.1, $200,000; and

4.4.2 1% of the base amount (as defined herein);

provided that for each Clause such minimum amount need not exceed $25,000,000.

4.4.3 For the purposes of this Rule 4.4, the term "base amount" shall mean the greater of:

(a) the aggregate of net equity for each client determined as the total value of cash and securities owed to the client by the Member less the total value of cash and securities owed by the client to the Member; and

(b) the total allowable assets of the Member determined in accordance with Statement A of Form 1.

4.5 **PROVISOS**. Provisos with respect to Rules 4.1, 4.2 and 4.4 shall be subject to the following:

4.5.1 The amount of insurance required to be maintained by a Member shall as a minimum be by way of a Financial Institution Bond with a double aggregate limit or a provision for full reinstatement.

4.5.2 Should there be insufficient coverage, a Member shall be deemed to be complying with this Rule 4 provided that any such deficiency does not exceed 10 percent of the insurance requirement and that evidence is furnished within two months of the dates of completion of the monthly operations questionnaires and the annual audit that the deficiency has been corrected. If the deficiency is 10% or more of the insurance requirement, action must be taken by the Member to correct the deficiency within 10 days of its determination and the Member shall immediately notify the Corporation.

4.5.3 A Financial Institution Bond maintained pursuant to Rule 4.1 may contain a clause or rider stating that all claims made under the bond are subject to a deductible.

4.6 **QUALIFIED CARRIERS**. Insurance required to be effected and kept in force by a Member pursuant to this Rule 4 may be underwritten directly by either (i) an insurer registered or licensed under the laws of Canada or any province of Canada or (ii) any foreign insurer approved by the Corporation. No foreign insurer shall be approved by the Corporation unless the insurer has the minimum net worth required of $75 million on the last audited balance sheet, provided acceptable financial information with respect to such corporation is available for inspection and the Corporation is satisfied that the insurer is subject to supervision by regulatory authorities in the jurisdiction of incorporation of the insurer which is substantially similar to the supervision of insurance companies in Canada.

4.7 **GLOBAL FINANCIAL INSTITUTION BONDS**. Where the insurance maintained by a Member in respect of any of the requirements under this Rule 4 names as the insured or benefits the Member, together with any other person or group of persons, whether within Canada or elsewhere, the following must apply:

4.7.1 the Member shall have the right to claim directly against the insurer in respect of losses, and any

payment or satisfaction of such losses shall be made directly to the Member; and

4.7.2 the individual or aggregate limits under the policy may only be affected by claims made by or on behalf of

(a) the Member, or

(b) any of the Member's subsidiaries whose financial results are consolidated with those of the Member,

without regard to the claims, experience or any other factor referable to any other person.

5 **RULE NO. 5 - BOOKS, RECORDS & REPORTING**

5.1 **REQUIREMENT FOR RECORDS**. Every Member shall keep such books, records and other documents as are necessary for the proper recording of its business transactions and financial affairs and the transactions that it executes on behalf of others and shall keep such other books, records and documents as may be otherwise required by the Corporation. Such books and records shall contain as a minimum the following:

5.1.1 blotters, or other records, containing an itemized daily record of:

(a) all purchases and sales of securities;

(b) all receipts and deliveries of securities, including certificate numbers;

(c) all receipts and disbursements of cash;

(d) all other debits and credits, the account for which each transaction was effected;

(e) the name of the securities;

(f) the class or designation of the securities;

(g) the number or value of the securities;

(h) the unit and aggregate purchase or sale price; and

(i) the trade date and the name or other designation of the person from whom the securities were purchased or received or to whom they were sold or delivered;

5.1.2 an adequate record of each order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such record shall show:

(a) the terms and conditions of the order or instructions and of any modification or cancellation thereof;

(b) the account for which entered or received; and

(c) the time of entry or receipt, the price at which executed and, to the extent feasible, the time of execution or cancellation;

5.1.3 where the order or instruction is placed by an individual other than the person in whose name the account is operated, or an individual duly authorized to place orders or instructions on behalf of a client that is a company, the name, sales number or designation or the individual placing the order or instruction shall be recorded;

5.1.4 copies of confirmations of all purchases and sales of securities and copies of all other debits and credits for securities, cash and other items for the account of clients;

5.1.5 a record of the proof of cash balances of all ledger accounts in the form of trial balances and a record of calculation of minimum capital, adjusted liabilities and risk adjusted capital required;

5.1.6 all cheque books, bank statements, cancelled cheques and cash reconciliations;

5.1.7 all bills receivable or payable (or copies thereof), paid or unpaid, relating to the business of the Member;

5.1.8 originals of all communications received and copies of all communications sent by such Member (including inter-office memoranda and communications) relating to the business as such;

5.1.9 all limited trading authorizations in respect of any account, and copies of resolutions empowering an agent to act on behalf of a corporation;

5.1.10 all written agreements (or copies thereof) entered into by such Member relating to their business as such, including leveraging documentation, disclosure materials and agreements relating to any account; and

5.1.11 all written documentation relating to an advance of funds or extension of credit to or on behalf of a client, directly or indirectly, in connection with the receipt of funds on the redemption of mutual fund securities, including the prior written confirmation referred to in Rule 3.2.3.

5.2 **STORAGE MEDIUM**. All records required to be maintained by a Member may be kept by means of mechanical, electrical, electronic or other devices provided:

5.2.1 such method of record keeping is not prohibited under other applicable legislation;

5.2.2 there are appropriate internal controls in place, to guard against the risk of falsification of the information recorded;

5.2.3 such method provides a means to furnish promptly to the Corporation upon request legible, true and

complete copies of those records of the member which are required to be preserved; and

5.2.4 the Member has suitable back-up and disaster recovery programs.

5.3 **CLIENT REPORTING**

5.3.1 **Delivery of Account Statement**. The Member shall send an account statement to each client in accordance with the following minimum standards:

(a) once every 12 months for a client name account;

(b) once a month for nominee name accounts (or accounts for which the Member is acting as agent of self-directed registered retirement savings plan) where there is an entry during the month and a cash balance or security position; and

(c) quarterly for nominee name accounts where no entry has occurred in the account and there is a cash balance or security position at the end of the quarter.

5.3.2 **Automatic Payment Plans.** Notwithstanding the provisions of Rule 5.3.1(a), where a Member holds client assets in nominee name and the only entry in the client's account in a month relates to the client's participation in an automatic payment plan that provides for systematic trading in the securities of a mutual fund on a monthly or more frequent basis, the Member shall send an account statement to the client quarterly.

5.3.3 **Contents of Account Statement**. Each account statement must contain the following information:

(a) for nominee name accounts or accounts where the Member acts as an agent for the trustee for the purposes of administering a self-directed registered retirement savings or similar plan:

(i) the opening balance;
(ii) all debits and credits;
(iii) the closing balance;
(iv) the quantity and description of each security purchased, sold or transferred and the dates of each transaction, and;
(v) the quantity, description and market value of each security position held for the account;

(b) for client name accounts:

(i) all debits and credits;
(ii) the quantity and description of each security purchased, sold or transferred and the dates of each transaction; and
(iii) for automatic payment plan transactions, the date the plan was initiated, a description of the security and the initial payment amount made under the plan.

(c) for all accounts:

(a) the type of account;
(ii) the account number;
(iii) the date the statement was issued;
(iv) the period covered by the statement;
(v) the name of the Approved Person(s) servicing the account; and
(vi) the name, address and telephone number of the Member.

5.3.4 **Restrictions**. Only transactions executed by the Member may appear on the statement of account.

5.4 **TRADE CONFIRMATIONS**

5.4.1 **Delivery of Confirmations**. Every Member who has acted as principal or agent in connection with any trade in a security shall promptly send by prepaid mail or deliver to the client a written confirmation of the transaction containing the information required under Rule 5.4.3. The Member need not send to its client a written confirmation of a trade in a security of a mutual fund where the manager of the mutual fund sends the client a written confirmation containing the information required to be sent under Rule 5.4.3.

5.4.2 **Automatic Payment Plans.** Where a transaction relates to a client's participation in an automatic payment plan that provides for systematic trading in the securities of a mutual fund on a monthly or more frequent basis, and the Member registers the mutual funds pursuant to the plan in nominee name, the Member is required to send a trade confirmation for the initial purchase only.

5.4.3 **Content**. Every confirmation of trade sent to a client must set forth the following information:

(a) the quantity and description of the security;

(b) the price per share or unit at which the trade was effected;

(c) the consideration;

(d) the name of the Member;

(e) whether or not the Member is acting as principal or agent;

(f) if acting as agent, the name of the person or company from or to or through whom the security was bought or sold;

(g) the type of the account through which the trade was effected;

(i) the commission, if any, charged in respect of the trade;

(i) the amount deducted by way of sales, service and other charges;

(j) the amount, if any, of deferred sales charges;

(k) the name of the Approved Person, if any, in the transaction;

(l) the date of the trade; and

(m) the settlement date.

5.5 **ACCESS TO BOOKS AND RECORDS**. All books, records, documentation and other information required to be kept and maintained by a Member or Approved Person shall be available for review by the Corporation and the Corporation shall be entitled to make copies thereof and retain them for the purposes of carrying out its objects and responsibilities under the applicable securities legislation, the By-laws or the Rules.

5.6 **RECORD RETENTION**. Each Member shall retain copies of the records and documentation referred to in this Rule 5 for seven years or such other time as may be prescribed by the Corporation.