**Summary of Public Comments Respecting Proposed Consequential Amendments Resulting from National Instrument 31-103 *Registration Requirements and Exemptions* – MFDA Rules 1.2 (Individual Qualifications); 2.4.2 (Referral Arrangements); 2.5 (Minimum Standards of Supervision); 5.3 (Client Reporting); and 5.6 (Record Retention) and MFDA Policy No. 6 *Information Reporting Requirements* and Responses of the MFDA**

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On December 23, 2009, the British Columbia Securities Commission and Ontario Securities Commission published proposed amendments to MFDA Rules 1.2 (Individual Qualifications); 2.4.2 (Referral Arrangements); 2.5 (Minimum Standards of Supervision); 5.3 (Client Reporting); and 5.6 (Record Retention) and MFDA Policy No. 6 *Information Reporting Requirements* (the "Proposed Amendments") for a 90-day public comment period.

The public comment period expired on March 23, 2010.

6 submissions were received during the public comment period:

1. BMO Investments Inc. ("BMO")
2. Desjardins Fédération des Caisses du Québec ("Desjardins")
3. IGM Financial Inc. ("IGM")
4. Investment Funds Institute of Canada ("IFIC")
5. Quadrus Investment Services Ltd. ("Quadrus")
6. Royal Mutual Funds Inc. ("RMFI") and Phillips, Hager & North Investment Funds Ltd. ("PH&N")

Copies of comment submissions may be viewed at the offices of the MFDA, 121 King Street West, Suite 1000, Toronto, Ontario by contacting Ken Woodard, Director, Communications and Membership Services, (416) 943-4602.

The following is a summary of the comments received, together with the MFDA's responses.

As a general matter, MFDA staff notes that proposed consequential amendments to MFDA Rules 1.2.1, 2.4.2 and 5.3.2 respecting proficiency, referral arrangements and content of account statement requirements have been put on hold pending the coming into force of revisions to such requirements under National Instrument 31-103 *Registration Requirements and Exemptions* ("NI 31-103") that are being made as part of the first year amendments to the Instrument.

## General Comments

BMO, IFIC, IGM, RMFI and PH&N expressed support for regulatory efforts to align MFDA requirements with those under NI 31-103 and recommended that initiatives of

securities regulatory authorities and self-regulatory organizations ("SROs") be developed in a coordinated and consistent way for the benefit of investors. IFIC and IGM noted that there are instances where the wording of the Proposed Amendments differs from the relevant wording in NI 31-103. These commenters suggested that to avoid uncertainty, and ensure consistency across distribution channels, the MFDA track the wording of NI 31-103 in the Proposed Amendments and only deviate from it where the context requires.

Citing MFDA Rule 2.5.1, Desjardins noted that it is evident that Members and Approved Persons are subject to applicable securities legislation and, as such, it should not be expressed in MFDA Rules.

### MFDA Response

MFDA staff has and continues to participate along with Investment Industry Regulatory Organization of Canada ("IIROC") and Canadian Securities Administrators ("CSA") staff on working groups convened by the CSA to ensure that regulatory proposals under development by the SROs are harmonized to the extent possible and meet the same regulatory standards as requirements under NI 31-103. Significant staff time and effort has gone into this process and, as a result of numerous working group discussions with CSA and IIROC staff and internal consultations, MFDA staff is confident that the Proposed Amendments are consistent with and meet regulatory standards established under NI 31-103.

Where the wording of conforming amendments to MFDA Rules differs from that used in the Instrument, this has been done to clarify (and not change) the regulatory intent of such requirements and to appropriately adapt them to MFDA Rules, having regard to the existing structure of the MFDA Rulebook (for example, certain requirements under NI 31-103 are addressed under MFDA Rules and subject to detailed guidance/clarification in other MFDA regulatory instruments). Staff will issue a Member Regulation Bulletin clarifying this matter.

In circumstances where it is appropriate, MFDA Rules and regulatory instruments make general reference to applicable requirements under securities legislation. The extent to which such references are made may vary depending upon the desirability of reminding Members of their additional obligations.

### Rule 1.2 – Individual Qualifications

BMO expressed the view that while Rule 1.2.1 is intended to reflect subsection 3.4(1) of NI 31-103, which is referred to as the "proficiency principle", the proposed drafting may not yield practical results. BMO requested clarification as to what the MFDA would be looking for in the course of a sales compliance audit to satisfy itself that the Member is operating in compliance with this Rule. BMO noted that in cases where an activity requires registration, the individual will either be registered or will be subject to the conditions of an order for discretionary relief and, if an individual is subject to proficiency requirements but not registration, such as a branch manager, the individual will meet the proficiency requirements of the branch manager category. In light of this,

BMO expressed the view that it is unclear under what circumstances an individual would be subject to, or when the MFDA would invoke, a reasonableness standard and that a proficiency principle does not appear to be well-suited or functional within the ambit of prescriptive Rules.

### MFDA Response

The proficiency principle in section 3.4 of NI 31-103 goes beyond formal registration and experience requirements to impose a general obligation to ensure that registered individuals acting on behalf of registered firms are, at all times, able to engage in registered activities competently. As noted in section 3.4 of Companion Policy 31-103 CP Registration Requirements and Exemptions ("31-103CP"), this would include requiring firms to perform their own analysis of all products they recommend to clients and providing product training to ensure their registered representatives have a sufficient understanding of products and risks to meet their suitability obligations.

The proficiency principle is also intended to address requirements for new roles such as the Ultimate Designated Person ("UDP"), which have now been adopted under NI 31-103 and MFDA Rules, which do not otherwise have specified proficiency/experience requirements. During a compliance review, MFDA staff will consider whether the individual has sufficient experience and qualifications to be in the UDP role. Where a role has specific proficiency/experience requirements under MFDA Rules and/or securities legislation (e.g. Salespersons, Branch Managers, Chief Compliance Officers), MFDA staff, on a compliance review, will look for compliance with such requirements.

As noted, proposed consequential amendments to Rule 1.2.1 have been put on hold pending the coming into force of revisions to section 3.4(1) under NI 31-103 that are being made as part of the first year amendments to the Instrument.

### Former Rule 1.2.3 – Trading Partners, Directors, Officers and Compliance Officers

Desjardins noted the proposed deletion of Rule 1.2.3 and requested confirmation that the MFDA does not intend to impose specific education and experience requirements for compliance officers, but rather will allow Members discretion in determining the proper standards in this area.

### MFDA Response

Although Rule 1.2.3 has been deleted from the MFDA Rulebook, the Chief Compliance Officers ("CCO") of Members will still be expected to meet all applicable proficiency/experience requirements established under securities legislation.

### Rule 2.1.4 – Conflicts of Interest

BMO, IGM and IFIC noted a difference between MFDA requirements with respect to conflicts of interest in Rule 2.1.4 and the provisions in NI 31-103. For example, IGM noted that the words "be aware" in section 2.1.4 impose a higher standard than "take reasonable steps to identify" in section 13.4 of NI 31-103 and that NI 31-103 has a materiality standard, which does not appear in Rule 2.1.4. IGM commented that, if the MFDA does not intend to have such a materiality standard, then to the extent a Member also has an exempt market dealer licence, the standards applicable to a client will be dependent on whether the Member is dealing with the client in respect of the mutual fund dealer licence or the exempt market dealer licence. BMO noted that consistency with respect to how firms deal with conflicts of interest would be particularly important for Members that are or will be registered in another category of registration, as such Members can then have a single conflicts of interest policy that will allow them to approach and address conflicts of interest in a uniform manner across all their categories of registration. BMO and IGM also noted that the MFDA Rule requires disclosure to clients in all instances while NI 31-103 recognizes that disclosure is not always appropriate.

IGM and IFIC expressed the view that, given this difference, it is not apparent which of the rules is more stringent and, therefore, the applicable standard with which a Member must comply is unclear. IFIC and IGM recommended that Rule 2.1.4 be redrafted to make it consistent with section 13.4 of NI 31-103 to avoid confusion and ensure consistency of application across the industry.

### MFDA Response

NI 31-103 and MFDA requirements with respect to conflicts of interest are consistent and meet the same regulatory objectives. Accordingly, by complying with MFDA requirements with respect to conflicts of interest, Members will be complying with requirements under NI 31-103.

Under Rule 2.1.4(a), Members and Approved Persons have an obligation to be aware of the possibility of conflicts of interest arising between the interests of the Member or Approved Person. In discharging this obligation, both the Member and Approved Person are expected to act reasonably, including taking reasonable steps to identify conflicts of interest as required under NI 31-103.

In applying Rule 2.1.4, MFDA staff has taken the position that the concept of materiality is implicit in the Rule. Member Regulation Notice MR-0054 *Conflicts of Interest* ("MR-0054"), issued on June 22, 2006, clarifies the obligations of Members with respect to the management of conflicts of interest under Rule 2.1.4 and notes that MFDA staff does not expect Members to anticipate every potential conflict, regardless of the remoteness of a problem arising, and provide written disclosure of such conflicts. However, written disclosure must be provided in all cases where there is a reasonable likelihood that a client would consider the conflict important when entering into a proposed transaction.

### Rule 2.4.2 – Referral Arrangements

## General Comments

IGM recommended that proposed Rule 2.4.2 be amended to clarify that subsection (b)(i) only applies where the arrangement is entered into by an Approved Person and not where the arrangement is entered into by Member itself.

RMFI and PH&N noted that the wording of proposed Rule 2.4.2 does not entirely correspond to that of the applicable sections of NI 31-103, for example, the wording of MFDA Rule 2.4.2(b)(iii) is not consistent with section 13.8(b) of NI 31-103. RMFI and PH&N expressed the view that such approach may lead to inconsistent interpretation of the requirements among different registrants and recommended that MFDA Rules fully conform to requirements under NI 31-103.

## MFDA Response:

The requirements under Rule 2.4.2 apply to both Members and Approved Persons. Where the wording of proposed Rule 2.4.2 differs from that used in respect of requirements for referral arrangements under NI 31-103, this, as noted, has been done to clarify (and not change) the regulatory intent of such requirements and to appropriately adapt them to MFDA Rules, having regard to the existing terminology and structure of the MFDA Rulebook. As noted, proposed consequential amendments to Rule 2.4.2 have been put on hold pending the coming into force of revisions to referral arrangement requirements under NI 31-103 that are being made as part of the first year amendments to the Instrument.

## Jurisdiction over Non-Securities Related Referral Arrangements

Quadrus expressed the view that the Proposed Amendments would result in the expansion of the jurisdiction of securities regulators into non-securities fields through the proposed inclusion of non-securities referrals in the Rules. Quadrus commented that the current MFDA Rule which requires all securities related referrals to be done through the Member is appropriate given that dealers have knowledge of the area and this is what securities regulators are expected to regulate. Quadrus noted that even though the majority of its Approved Persons are dually licensed for both mutual funds and life insurance, some clients do not purchase mutual funds and only conduct insurance business with the Approved Person. In light of this, Quadrus expressed the view that a mutual fund dealer should not oversee Approved Persons' dealings with their life insurance clients, as may be required under the Proposed Amendments.

Quadrus expressed the view that Members will not be able to authorize referrals and still comply with the Proposed Amendments without assuming an excessive amount of potential liability. The exposure to liability and the resources needed to ensure proper supervision would far outweigh any monetary benefits of referral arrangements to Members or Approved Persons.

Quadrus expressed concern that the due diligence requirement in proposed Rule 2.4.2(c) will require Members to supervise activities in which they do not have expertise and expose them to an unreasonable level of risk. Quadrus commented that, while dealers can reasonably be expected to have the ability to review and assess "securities related referrals", they should not be expected to review and assess other service professionals. Quadrus expressed concern that this requirement will result in many dealers simply banning referrals of any kind and noted that this would negatively impact clients who often look to their Approved Person as a knowledgeable source for referrals. Quadrus also expressed concern that banning such referrals would lead to them going "underground" and requested clarification as to dealers' responsibility in policing these situations. Quadrus noted that Members have no way of easily determining whether an Approved Person has made a compensated referral in violation of its ban, which would impose an almost-impossible compliance burden on dealers, with little or no public policy rationale for it.

### MFDA Response

We acknowledge the comment that the Proposed Amendments constitute a significant expansion from the current MFDA Rule, which is limited to referral arrangements in respect of securities related business. The proposed amendments to Rule 2.4.2 were made to conform MFDA requirements for referral arrangements with requirements established under Part 13 of NI 31-103.

### Definition of Referral Fee

Quadrus expressed the view that the definition of "referral fee" in section 2.4.2(a)(iii), which includes "any form of compensation, direct or indirect", leaves considerable room for interpretation and requested clarification whether such incentives as tickets to a sporting event or Christmas gifts fall within the scope of "indirect compensation".

### MFDA Response

The definition of referral fee in Rule 2.4.2(a)(iii) conforms to that included in section 13.7 of NI 31-103 and includes non-monetary compensation. CSA Staff Notice 31-313 *NI 31-103 Registration Requirements and Exemptions and related instruments – Frequently Asked Questions as of December 18, 2009* states that: "Referral Fee is defined in section 13.7 as *any* form of compensation. For example, gift certificates would be included."

### Rules 2.5.2 and 2.5.3 – Ultimate Designated Person and Chief Compliance Officer

IGM and IFIC noted that the use of the term "reasonably" in sections (A) and (B) of proposed Rule 2.5.3(b)(iii) is not consistent with the wording used in subsections 5.2(c)(i) and (ii) of NI 31-103, which use the words "in the opinion of a reasonable person". BMO, IGM and IFIC also noted that Rule 2.5.3(b)(iv), which proposes that a report be submitted to the Board of Directors "as frequently as necessary and not less

than annually", is inconsistent with section 5.2(d) of NI 31-103, which requires a report to be submitted "annually" and recommended harmonizing the wording of this section with that of NI 31-103.

BMO expressed the view that harmonization between the Rules and NI 31-103 in this area would be particularly important for Members who have other categories of registration, as this would allow the CCO to implement a uniform escalation and reporting policy to the firm's Board. Moreover, BMO requested clarification whether the CCO will be free to determine what frequency is "necessary" based on his or her judgment, or if the MFDA intends to use criteria against which it will judge post facto whether it was necessary for the CCO to report to the Board more frequently than annually. BMO also noted that the proposed requirement to report as frequently as necessary is not consistent with MR-0057 *Joint Regulatory Notice on the Role of Compliance and Supervision*, which states that "[t]he Chief Compliance Officer must report the results from its monitoring to management and the board of directors at least annually, but should have direct access to senior management as needed to report significant issues as they arise."

### MFDA Response

MFDA staff is of the view that the wording adopted in Rule 2.5.3(b)(iii) is appropriate for the purpose of ensuring compliance with MFDA Rules and is consistent with the regulatory intent of section 5.2 of NI 31-103, as both provisions are based on a standard of reasonableness.

MFDA staff is of the view that Rule 2.5.3(b)(iv), as proposed, is appropriate, having regard to the role of the CCO and the purpose of the report to the Board, which is to provide the Board with reasonable assurance that all standards and requirements of applicable laws and regulations are being met. For the CCO to monitor and Board to assess firm compliance with securities legislation and MFDA Rules adequately, the CCO must have the ability to report issues to the Board in a timely manner. This may, on occasion, require reporting to the Board on a more frequent basis than annually. The proposed amendments are also consistent with section 11.4 of NI 31-103 which requires a registered firm to permit its UDP and CCO direct access to the Board of Directors at such times as the UDP or the CCO *may consider necessary or advisable in view of his or her responsibilities.*

The CCO would be required to determine, based on a reasonable exercise of his/her judgment, whether it is necessary to report to their Board more frequently than annually. During compliance reviews, MFDA staff will consider whether the CCO's exercise of judgment was reasonable, having regard to requirements under MFDA Rules and securities legislation. We note that this standard does not represent a change to current practice.

In addition to the responses above, we note that Rule 2.5.3, as proposed, is consistent with sections 5.2, 11.3 and 11.1 of 31-103CP respecting the responsibilities and designation of the CCO and the general requirement for registered firms to have

compliance systems with internal controls and mechanisms that are likely to identify non-compliance at an early stage and allow the firm to correct non-compliant conduct in a timely manner.

MFDA staff is of the view that the Rule, as revised, is consistent with MR-0057. The Member Regulation Notice specifies a minimum frequency of *at least annually* but does not preclude more frequent reporting in the event that this becomes necessary.

### Rule 2.5.5 – Branch Manager Supervision

BMO, IGM and IFIC noted that proposed Rule 2.5.5 is a departure from the MFDA's efforts to harmonize regulation across the industry as the branch manager category is no longer a category of registration. BMO and IGM noted recent amendments made by the IIROC, which eliminated its branch manager category and recommended adopting IIROC's approach of removing prescriptive requirements.

BMO, IGM, IFIC, RMFI and PH&N recommended that the MFDA replace the proposed Rules with respect to branch managers with a more flexible concept of supervision of branches that accords with section 11.1 of NI 31-103.

IGM, IFIC, RMFI and PH&N expressed the view that in today's fluid environment, it seems overly restrictive to mandate particulars such as the number of Approved Persons per branch and to stipulate requirements for physical locations and recommended that Members be allowed the option for a structure that meets branch manager controls based on risk management.

### MFDA Response

As set out in the Notice accompanying the proposed amendments, MFDA staff, based on their compliance and enforcement experience to date, is of the view that the branch manager supervisory structure continues to be necessary to ensure appropriate supervision of Approved Persons at the branch level.

With respect to IIROC's removal of the branch manager category of registration and supervisory structure, we note that IIROC members engage in non-retail activities where such a supervisory structure would not necessarily be appropriate, whereas MFDA Members transact exclusively in the retail market. In addition, IIROC members have been subject to numerous compliance reviews and are very familiar with and accustomed to complying with their obligations in this area. The MFDA, in contrast, has only recently completed its second cycle of compliance examinations. While issues identified in our examinations indicate that a more prescriptive approach remains appropriate for MFDA Members at this time, staff will continue to monitor and assess Member compliance over time with a view to considering whether branch manager requirements should be amended in the future.

### Rule 2.5.5(d) – Currency of Courses

IGM, IFIC, RMFI and PH&N noted that proposed Rule 2.5.5(d) does not include the provisions found in section 3.3 of NI 31-103, which provide that an individual may meet the relevant proficiency requirements by having gained relevant industry experience for a total of 12 months during the 36-month period. BMO, IFIC, RMFI and PH&N also noted that section 2.5.5(d) does not allow for proficiency requirements to be met by an individual having been previously registered in an equivalent category, which is permitted under current MFDA Rules and section 3.3 of NI 31-103. BMO and IFIC recommended that the MFDA allow for this type of previous registration to qualify as a way to meet the required proficiency.

IGM and IFIC expressed the view that these inconsistencies will cause certain individuals who would otherwise be qualified to have to undergo unnecessary testing or require an exemption from the MFDA, even though they meet the proficiency requirements under NI 31-103. BMO, Desjardins, IGM and IFIC recommended that the MFDA adopt similar wording to that found in NI 31-103 in order to ensure harmonization and avoid the unwarranted consequences of not including such proficiency flexibility.

RMFI and PH&N recommended that, to be consistent with the adoption of the examination-based model, Rule 2.5.5(d) (Currency of Courses) be renamed "Currency of Examination" and recommended that, if the examination-based model is intended to apply to the MFDA Rules generally as opposed to Rule 2.5.5 specifically, this paragraph be made into a stand-alone rule (for example, a new Rule 2.5.6). If however this paragraph is intended to apply to Rule 2.5.5 only, RMFI and PH&N recommended that the wording of the Rule be amended accordingly (for example, instead of indicating "For the purposes of the Rules, an individual is deemed ... ", it should indicate "A Branch Manager is deemed ... ").

### MFDA Response

With respect to amending “Currency of Courses” to “Currency of Examination” and making proposed Rule 2.5.5(d) a stand alone Rule, we acknowledge the comments and will make these changes.

MFDA staff is of the view that Rule 2.5.5(d), as proposed, is consistent with and meets the same regulatory objectives as NI 31-103.

Rule 2.5.5(d) adopts the same 36-month currency period as set out in subsection 3.3(1) of NI 31-103. In addition, Rule 2.5.5(d) allows the MFDA discretion, on a case-by-case basis, to consider a longer course currency period provided that the MFDA is satisfied that, based on the individual's experience, their knowledge and proficiency remains relevant and current. In determining whether an individual’s knowledge and proficiency is relevant and current, MFDA staff will consider the factors set out in the National Instrument, for example, previous registration and relevant securities industry experience. As discretion is contained within the Rule, no formal exemption application is required and, in practice, a review of alternate proficiency or course currency under this section is usually done by way of informal written requests and the provision of relevant information. In circumstances where relief from the course currency requirements of NI

31-103 is sought from the CSA, Members may submit their informal written requests to the MFDA concurrently and provide the same information to the MFDA that is being submitted to the CSA for its consideration.

### Rules 5.3.2 and 5.3.3 – Content of Account Statements

IGM, IFIC and RMFI and PH&N noted that sections (b) and (c) of Rule 5.3.2 add a requirement for Members to report not just "securities" transactions but also "investments" and requested clarification as to what is intended by this wording. The commenters expressed the view that since section 14.14 of NI 31-103 does not contain the term "investments", this inconsistency will confuse Members and recommended that the reference to "investments" be deleted from sections 5.3.2(b) and (c) in order to harmonize with NI 31-103 and to avoid confusion.

### MFDA Response

Although section 14.14 of NI 31-103 limits account statement content requirements to reporting transactions in respect of securities, MFDA Members typically transact in securities as well as other investment products that may not meet the definition of a security in all CSA jurisdictions (e.g. Principle Protected Notes and Guaranteed Investment Certificates) and we note that it is appropriate for all such transactions to be reflected on account statements. In addition, we note that the amendments, as currently proposed, are consistent with IIROC account statement content requirements and would, as a result, allow Members with IIROC affiliates to harmonize the content of their account statements.

As noted, proposed consequential amendments to account statement content requirements under Rule 5.3.2 have been put on hold pending the coming into force of revisions to such requirements under NI 31-103 that are being made as part of the first year amendments to the Instrument.

### Transition Period

Desjardins and IFIC noted that while sections 16.17(1) and (2) of NI 31-103 provide a mutual fund dealer with a two-year transition period for compliance with section 14.14 of the Instrument, the Proposed Amendments do not include any transitional provisions.

RMFI and PH&N recommended that, given the timelines for submission of comment letters in response to the Proposed Amendments, transition dates for the Proposed Amendments be determined independently rather than be harmonized with those under NI 31-103.

### MFDA Response

MFDA staff is aware that requirements adopted under NI 31-103 are subject to specific transition periods. As was noted under Part III, Section D (Effective Date) of the Notice

accompanying the Proposed Amendments, the MFDA will harmonize its transition periods with those under NI 31-103.

MFDA staff notes, however, that it is not appropriate to extend transition periods for its consequential Rule amendments beyond those established under NI 31-103, as certain requirements under the Instrument (i.e. those in respect of referral arrangements) are already in effect.

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