

## **THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

### **HOUSEKEEPING AMENDMENTS TO MFDA RULE 2.4.2 (REFERRAL ARRANGEMENTS)**

#### **Background**

On September 28, 2009 National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”) came into force. NI 31-103 introduced new requirements in the area of referral arrangements. Referral arrangement requirements under NI 31-103 superseded requirements under MFDA Rule 2.4.2.

MFDA Bulletin #0396-P (published September 15, 2009), summarized the difference between referral arrangement requirements under Rule 2.4.2 and NI 31-103 and advised Members that MFDA Rules would be amended to harmonize with requirements under the Instrument. The Bulletin also noted that Members had six months from September 28, 2009 to comply with the new requirements for referral arrangements, including referral arrangements entered into prior to NI 31-103 coming into effect.

On December 23, 2009, proposed conforming amendments to MFDA Rules, including Rule 2.4.2, were published for comment. The purpose of these amendments was to ensure that requirements under MFDA Rules were consistent with those established under NI 31-103. The proposed conforming amendments to Rule 2.4.2 were subsequently put on hold pending additional amendments to referral arrangement requirements under NI 31-103. Such additional amendments were made by the Canadian Securities Administrators (“CSA”) in a subsequent publication of the Instrument.

MFDA Rules are required to conform to requirements under securities legislation. The proposed conforming amendments to Rule 2.4.2 are being brought forward at this time, as there have been no further amendments to referral arrangement requirements under NI 31-103. Attached as Schedule “A” are proposed changes to MFDA Rule 2.4.2. The current version of the Rule has been blacklined to show changes introduced by the proposed amendments.

#### **Nature of the Amendments**

The proposed amendments directly adopt referral arrangement requirements under NI 31-103 and are housekeeping in nature. As noted, such changes are reasonably necessary to conform MFDA Rule 2.4.2 to referral arrangement requirements under NI 31-103. The proposed amendments will not have a material impact on investors, issuers, registrants, other market participants, the MFDA, the MFDA Investor Protection Corporation or the Canadian capital markets.

#### **Exemption from Requirements under Securities Legislation**

The proposed amendments do not involve a Rule that the MFDA, its Members or Approved Persons must comply with in order to be exempted from a securities legislation requirement.

**Process**

The MFDA followed its established internal governance practices in approving the proposed amendments and considered the need for consequential amendments. On February 26, 2015, the MFDA Board of Directors approved the proposed amendments. The Board has determined that the proposed amendments are in the public interest.

**Conflict with Applicable Laws or Terms and Conditions of Recognition Order**

The proposed amendments do not conflict with applicable laws or the Terms and Conditions of a Recognizing Regulator's Recognition Order.

**Effective Date**

The proposed amendments to Rule 2.4.2 will become effective on a date to be subsequently determined by the MFDA.

**DM#413386v2**

## Schedule "A"

### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

On February 26, 2015, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA Rule 2.4.2:

#### 2.4.2 Referral Arrangements

(a) Definitions. For the purpose of this Rule 2.4.2:

- (i) "client" includes a prospective client;
  - (ii) "referral arrangement" means any arrangement in which a Member or Approved Person agrees to pay or receive a referral fee; and
  - (iii) "referral fee" means any form of compensation, direct or indirect, paid for the referral of a client to or from a Member or Approved Person.
- ~~(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 do not constitute securities related business.~~

(b) Permitted Referral Arrangements. A Member or Approved Person must not participate in a referral arrangement with another person or company unless: Referral arrangements may only be entered into on the following basis:

- (i) before a client is referred by or to the Member or Approved Person, the terms of the referral arrangement are set out in a written agreement between the Member and the person or company; 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) the Member records all referral fees; and there is a written agreement governing the referral arrangement prior to implementation;
- (iii) the Member or Approved Person ensures that the information prescribed under Rule 2.4.2(d)(i) is provided to the client in writing before the party receiving the referral either opens an account for the client or provides services to the client. 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 or an example of how the referral fee is calculated, 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 so trade or advise.~~

(c) **Verifying the Qualifications of the Person or Company Receiving the Referral.** A Member or Approved Person must not refer a client to another person or company unless the Member first takes reasonable steps to satisfy itself that the person or company has the appropriate qualifications to provide the services, and if applicable, is registered to provide those services.

(d) **Disclosing Referral Arrangements to Clients**

(i) The written disclosure of the referral arrangement required under Rule 2.4.2(b)(iii) must include the following:

- (a) the name of each party to the agreement referred to under Rule 2.4.2(b)(i);
- (b) the purpose and material terms of the agreement, including the nature of the services to be provided by each party;
- (c) any conflicts of interest resulting from the relationship between the parties to the agreement and from any other element of the referral arrangement;
- (d) the method of calculating the referral fee and, to the extent possible, the amount of the fee;
- (e) the category of registration of each registrant that is a party to the agreement with a description of the activities that the registrant is authorized to engage in under that category and, giving consideration to the nature of the referral, the activities that the registrant is not permitted to engage in;
- (f) if a referral is made to a registrant, a statement that all activity requiring registration resulting from the referral arrangement will be provided by the registrant receiving the referral; and
- (g) any other information that a reasonable client would consider important in evaluating the referral arrangement.

(ii) If there is a change to the information set out under Rule 2.4.2(d)(i), the Member or Approved Person must ensure that written disclosure of that change is provided to each client affected by the change as soon as possible and no later than the 30<sup>th</sup> day before the date on which a referral fee is next paid or received.