

# **MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

## **PROPOSED AMENDMENTS TO SECTION 35 (NO ACTIONS AGAINST THE CORPORATION) OF MFDA BY-LAW NO. 1**

### **I. OVERVIEW**

#### **A. Current By-Law**

The current By-laws of the MFDA do not provide specifically for the relationship of the MFDA or its Members with MFDA Investor Protection Corporation ("MFDA IPC"). This circumstance is relevant in two important respects. First, section 35 of MFDA By-law No. 1 provides protection to the MFDA and certain specified persons and bodies, such as its Board of Directors, committee members, officers and staff from legal action and proceedings by Members, Approved Persons and others under the jurisdiction of the MFDA but that protection does not extend to MFDA IPC or its corresponding persons and bodies. Second, the MFDA IPC does not have direct jurisdiction over MFDA Members and relies on the MFDA and, to a certain degree, provincial securities legislation to ensure compliance by MFDA Members with the MFDA IPC requirements.

#### **B. The Issues**

The MFDA and MFDA IPC are of the view that the protections of section 35 of MFDA By-law No. 1 should extend to the MFDA IPC and also certain persons and bodies of the MFDA IPC such as its Board of Directors, committee members, officers, employees and agents, so that the work of the MFDA IPC is not constrained by threat of legal action. In addition, it is proposed that certain key requirements that MFDA Members and their personnel must comply with in respect of the MFDA IPC should be specifically provided for in the MFDA By-laws on the basis that MFDA has jurisdiction over and would act to ensure that its Members and their Approved Persons comply with the MFDA IPC requirements.

#### **C. Objectives**

The objectives of the proposed amendments are: (i) to ensure that the MFDA IPC and its directors, officers and personnel are adequately protected in the discharge of their investor protection mandate from legal actions by MFDA Members, Approved Persons or other persons under the jurisdiction of the MFDA; and (ii) to provide for, within the MFDA By-laws, the terms of the relationship between the MFDA and MFDA IPC and existing MFDA and Member obligations to the MFDA IPC.

#### **D. Effect of Proposed Amendments**

The proposed amendments will provide protection to the MFDA IPC, its directors, officers and personnel in a manner similar to that already available to the MFDA and the specified persons and bodies under section 35 of By-law No. 1. The proposed amendments will also provide that Member obligations to the MFDA IPC are clear and can be enforced through the MFDA. The effect of the amendments will assist both the MFDA and MFDA IPC in their mandates of protecting customers of MFDA Members in the public interest. The ability of the MFDA IPC to ensure that its risk management and customer protection objectives can be met is consistent with MFDA's regulatory objectives.

## **II. DETAILED ANALYSIS**

### **A. Relevant History**

The MFDA IPC commenced coverage on July 1, 2005 having been previously established under the sponsorship of MFDA. The recognition orders of the relevant members of the Canadian Securities Administrators ("CSA") in respect of MFDA require that MFDA cooperate with the MFDA IPC as a compensation fund that has been approved by such CSA members ("Recognizing Regulators"). In particular, the MFDA Rules must provide for the authority of MFDA to assess its Members and require payment of such assessments in respect of the MFDA IPC as a compensation fund. The MFDA By-laws at that time provided for such assessment authority but did not otherwise provide for the relationship of the MFDA IPC with MFDA or MFDA with its own Members in respect of their obligations to the MFDA IPC.

The MFDA IPC was approved by order of certain of the Recognizing Regulators and such orders provided, among other things, for the MFDA IPC to engage in mutual fund dealer industry risk management assessment and ensure that it is able to fulfill its mandate including, among other things, identifying and dealing with MFDA Members that may be in financial difficulty. Such orders also contemplated the MFDA IPC and MFDA entering into agreements that would, among other things, provide for appropriate sharing of information such that the MFDA IPC could fulfill its mandate and manage risk to the public. MFDA and MFDA IPC entered into an agreement dated as of July 1, 2005 (the "Administration Agreement") that provided for the basis on which MFDA would regulate its Members in a manner that was consistent with the risk management objectives of the MFDA IPC and prudential regulation. However, the Administration Agreement and the MFDA By-laws and Rules recognize the fact that MFDA IPC has no direct jurisdiction by way of corporate law, contract or otherwise over Members of the MFDA.

Since the establishment of MFDA IPC in July 2005, MFDA and MFDA IPC have been able to examine and assess their respective mandates and to consider improvements that would be consistent with their common objective of customer protection. This process has been assisted by the experience of both organizations over the past few years. In addition, the relationship between the Investment Industry Regulatory Organization of Canada ("IIROC", formerly the Investment Dealers Association of Canada – "IDA") and Canadian Investor

Protection Fund ("CIPF"), organizations corresponding to MFDA and MFDA IPC, respectively, for securities dealers, was being examined and realigned by those organizations. In particular, the role of CIPF was being changed from a prudential standard setting organization with some regulatory oversight of IIROC to a passive fund similar in most respects to the MFDA IPC. As part of such change, it was recognized that it was important from the point of view of CIPF's risk management obligations, and IIROC's customer protection mandate, that the relationship of both IIROC and IIROC members to CIPF be better defined and formalized. Accordingly, amendments similar to those proposed by MFDA in this Notice were made by IIROC in respect of the role and relationship of CIPF with IIROC and its members. The corresponding amendments to section 35 of MFDA By-law No. 1 were enacted in IIROC (then IDA) By-law 21 relating to No Actions Against the Association and Others; and the provisions corresponding to new section 35A of MFDA By-law No. 1 were in IIROC Rule No. 41, as noted in the Ontario Securities Commission Bulletin at (2006) 29 OSCB 8181.

## **B. Proposed Amendments**

### Proposed Amendments to Existing Section 35

The proposed amendments to section 35 of MFDA By-law No. 1 will extend the protection from legal actions and proceedings by MFDA Members, Approved Persons and others to the MFDA IPC and specified persons and bodies by amending the text of the section to:

- include references to no actions being brought against the MFDA IPC, its Board of Directors, any of its committees or its officers, employees and agents; and
- provide that such actions, which are prohibited "in respect of any penalty imposed or any act or omission done under the provisions of and in compliance with or intended compliance with the provisions of any By-law, Rule or Policy", be extended by adding the wording: "and, in addition, in the case of the MFDA IPC, its letters patent, by-laws and policies and all regulatory directives or agreements thereunder".

### Proposed New Sections 35A.1 and 35A.2

The intent of these new sections is to provide for MFDA and MFDA Member obligations to the MFDA IPC.

Proposed new section 35A.1 to By-law No. 1 will provide that:

- the MFDA is authorized to enter into and perform its obligations under such agreements or other arrangements with the MFDA IPC as may be consistent with the objects of the MFDA (which would include the Administration Agreement); and
- the President, his or her staff or any other person designated by the Board of Directors shall be authorized to execute and deliver any such agreements, or make any such arrangements, and to do all acts and things as may be necessary to permit the MFDA to exercise its rights or perform its obligations thereunder.

New section 35A.2 would provide that, in respect of the Administration Agreement or other agreements and arrangements entered into by the MFDA in accordance with section 35A.1 from time to time, each Member:

- shall promptly pay to the MFDA all regular and special assessments levied or prescribed by the MFDA IPC in respect of any Member or groups of Members;
- shall provide to the MFDA IPC such information as is contemplated to be provided by Members in connection with the assessment of the financial condition of Members or risk of loss to the MFDA IPC;
- acknowledges and consents to the exchange of information between the MFDA and MFDA IPC relating to Members, their partners, directors, officers, shareholders, employees and agents, customers or any other persons permitted by law in accordance with any information sharing agreements or arrangements made by them;
- shall permit the MFDA IPC to conduct reviews of such Member or designated groups of Members as contemplated by the Administration Agreement or other arrangements and to fully cooperate with the MFDA IPC, and their respective staff and advisers, in connection with such reviews including, without limitation, the exercise by the MFDA IPC of such powers as are available to the MFDA and its officers, staff or other designates pursuant to sections 21 and 22 of MFDA By-law No. 1; and
- shall comply with such actions as the MFDA IPC may direct the MFDA to take with respect to a Member, or with such actions as the MFDA IPC may take on behalf of the MFDA as authorized.

### **C. Issues and Alternatives Considered**

The MFDA and MFDA IPC considered whether other legal relationships between MFDA Members and MFDA IPC could be established in order for MFDA IPC to be able to fulfill its customer protection and risk management mandates. One model that was considered was creating a member relationship between MFDA Members and MFDA IPC, i.e. MFDA Members would become members of MFDA IPC for corporate law purposes. This model would substantially change the governance structure of MFDA IPC and, as a matter of regulatory policy, it was not considered appropriate that the entities whose customers were being protected by the MFDA IPC as a customer compensation body would have a governance role as members in MFDA IPC itself. Another model that was considered was a direct contractual relationship between MFDA Members and MFDA IPC such that MFDA IPC could directly exercise jurisdiction with respect to MFDA Members and require payment of assessments and the performance of other obligations necessary for the Fund's operation. Although this model has some theoretical attraction, the effect of the contractual relationship could be created by simpler means through the proposed amendments to the MFDA By-laws. Creating an administrative link between MFDA IPC and all MFDA Members, including the execution of a separate agreement, would add unnecessary complexity and cost to the MFDA Member structure. As indicated above, the model reflected in the proposed amendments to the MFDA By-laws reflects the structure adopted

by IIROC and CIPF and is generally consistent with the way in which the activities of both MFDA IPC and CIPF have been conducted to date.

#### **D. Comparison with Similar Provisions**

As noted, amendments to IIROC (then IDA) By-law 21 (No Action Against the Association and Others) and new IIROC (IDA) Rule No. 41 (Canadian Investor Protection Fund) were made to extend the existing no action protection in the By-law so as to include CIPF and specified persons and bodies and to provide for IIROC and individual member firm obligations to CIPF. These amendments were approved/not objected to by the relevant CSA members in August, 2008.

The objectives of the proposed new sections 35A.1 and 35A.2 of MFDA By-law No. 1 are similar in all material respects to the above-noted amendments of IIROC.

The principle that a customer protection fund such as MFDA IPC would have the benefit of immunity from legal actions and proceedings as proposed in section 35 of MFDA By-law No. 1 is reflected in other funds that MFDA IPC has identified. For instance, the former provincial contingency plans established in the Provinces of British Columbia, Ontario, Quebec and Nova Scotia, as well as the current Fonds d'indemnisation des services financiers (Quebec), all have or had immunity provisions. The same principle of immunity is reflected in the legislation establishing the Securities Investor Protection Corporation in the United States (the insolvent securities dealer customer protection fund). The Canadian Deposit Insurance Corporation ("CDIC") also enjoys statutory immunity under its enabling legislation.

#### **E. Systems Impact of Amendments**

It is not anticipated that there will be a significant systems impact on Members as a result of the proposed amendments.

#### **F. Best Interests of the Capital Markets**

The Board has determined that the proposed amendments are consistent with the best interests of the capital markets.

#### **G. Public Interest Objective**

The proposed amendments are in the public interest and will provide for the relationship between MFDA IPC and the MFDA within MFDA By-laws, while also providing within the MFDA By-laws for MFDA Member obligations to the MFDA IPC.

The proposed amendments will also extend existing legal action or proceeding protection to the MFDA IPC and specified persons and bodies and, thereby, provide them with an appropriate degree of protection in the discharge of their investor protection mandate.

### **III. COMMENTARY**

#### **A. Filing in Other Jurisdictions**

The proposed amendments will be filed for approval with the Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

#### **B. Effectiveness**

The proposed amendments are simple and effective.

#### **C. Process**

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on March 5, 2009.

#### **D. Effective Date**

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

### **IV. SOURCES**

MFDA By-law No. 1  
Proposed amendments to IIROC (then IDA) By-law 21  
Proposed IIROC (then IDA) Rule No. 41

### **V. REQUIREMENT TO PUBLISH FOR COMMENT**

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

**The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments.** Comments should be made in writing. One copy of each comment letter should be delivered within 90 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Sarah Corrigan-Brown, Senior Legal Counsel, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at [www.mfda.ca](http://www.mfda.ca).

Questions may be referred to:

Jason Bennett  
Corporate Secretary & Director, Regional Councils  
Mutual Fund Dealers Association of Canada  
(416) 943-7431

DOCs# 176730v2

## SCHEDULE A

### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

#### NO ACTIONS AGAINST THE CORPORATION

##### (SECTION 35 OF MFDA BY-LAW NO. 1)

On March 5, 2009, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to section 35 of MFDA By-law No. 1 (No Actions Against the Corporation):

#### **35. 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 26, 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, or against MFDA Investor Protection Corporation, its Board of Directors, any of its committees or its officers, employees and agents, 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 and, in addition, in the case of MFDA Investor Protection Corporation, its letters patent, by-laws and policies and all regulatory directives or agreements thereunder.

#### **35.A MFDA INVESTOR PROTECTION FUND**

35A.1. The Corporation is authorized to enter into and perform its obligations under such agreements or other arrangements with MFDA Investor Protection Fund ("IPC") as may be, in the discretion of the Board of Directors, consistent with the objects of the Corporation including, without limitation, the Administration Agreement dated as of July 1, 2005, made between the Corporation and IPC, as the same may be amended from time to time (the "Administration Agreement"). The President, his or her staff or any other person designated by the Board of Directors shall be authorized to execute and deliver any such agreements, or make any such arrangements, and to do all acts and things as may be necessary to permit the Corporation to exercise its rights or perform its obligations thereunder.

35A.2. In respect of the Administration Agreement or other agreements and arrangements entered into by the Corporation in accordance with Section 35A.1 from time to time, each Member:

(a) shall promptly pay to the Corporation all regular and special assessments levied or

prescribed by IPC in respect of any Member or Members;

- (b) shall provide to IPC such information as is contemplated to be provided by Members in connection with the assessment of the financial condition of Members or risk of loss to IPC;
- (c) acknowledges and consents to the exchange between the Corporation and IPC of information relating to Members, their partners, directors, officers, shareholders, employees and agents, customers or any other persons permitted by law in accordance with any information sharing agreements or arrangements made by them;
- (d) shall permit IPC to conduct reviews of such Member or designated groups of Members as contemplated by the Administration Agreement or other arrangements and to fully cooperate with IPC, and their respective staff and advisers, in connection with such reviews including, without limitation, the exercise by IPC of such powers as are available to the Corporation and its officers, staff or other designates pursuant to Sections 21 and 22;
- (e) shall comply with such actions as IPC may direct the Corporation to take with respect to a Member, or with such actions as IPC may take on behalf of the Corporation as authorized.