



British Columbia Securities Commission

December 14, 2000

Dear Sirs:

Re: Firms registered as Mutual Fund Dealers who are also  
Mutual Fund Managers and/or Portfolio Managers

As you know, provincial securities regulators considering recognition of the Mutual Fund Dealers Association of Canada are at various stages of making rules requiring mutual fund dealers to join a self regulatory organization for mutual fund dealers (collectively, "Membership Rules"). Staff in these jurisdictions have received inquiries from registrants whose registration as mutual fund dealer is used to carry on what they perceive as an incidental or secondary part of their business. These registrants submit that mandatory membership in a SRO is not appropriate due to the nature of their business. These registrants carry on a primary business that falls into two broad categories:

- (1) Mutual fund managers who do not sell their sponsored mutual funds directly to the public but are registered as mutual fund dealers to enable them to carry on incidental sales and marketing activities.
- (2) Portfolio managers conducting a money management business and who are also registered as mutual fund dealers to enable them to sell their mutual funds (pooled funds) to their discretionary account clients or directly to the public.

#### **Mutual Fund Managers**

Staff understand that mutual fund managers not carrying on a direct mutual fund distribution business are nonetheless registered as mutual fund dealers for several reasons:

- a) they are concerned that their marketing and wholesaling activities vis a vis their mutual funds subject them to the registration requirement;
- b) they believe that they require this registration to fulfil their role as principal distributor of their funds;
- c) they became registered when the provincial securities regulators required an underwriter certificate for mutual fund prospectuses and have maintained that registration;
- d) they take purchase and redemption orders, including switch requests, directly from clients who hold mutual fund units in "client name", particularly when the client's original dealer does not consider the client an active client; or
- e) they believe that this registration is necessary to service house accounts of employees and family members of employees and various service providers to the manager.

Mutual fund managers carrying on the activities listed in paragraphs (a), (b) or (c) should consider whether they wish to continue their registration or apply for an exemption from registration. Staff have concluded that it may be appropriate to exempt mutual fund managers carrying on the activities listed in paragraphs (a), (b), and (c) from the requirement to obtain registration as a mutual fund dealer. Mutual fund managers who do not deal directly with clients, other than to process redemption orders received directly in accordance with National Instrument 81-102 Mutual Funds only, should consider whether existing exemptions from registration relating to those processing only redemptions of securities apply to them.

In addition, provided the activities are limited and incidental to their primary activity of managing mutual funds, mutual fund managers who accept purchase and switch orders in the circumstances described in (d), or who carry out the activities described in (e) may wish to apply for an exemption from the Membership Rules. Registrants making an application for exemption should explain the reasons why they are registered as mutual fund dealers and describe the full extent of their trading activities. Applications will be considered on a case-by-case basis by the applicable regulator. Staff will likely recommend relief from the Membership Rules in circumstances where staff agree that the registrable activities are limited and incidental to an applicant's

business. Registrants who are exempted from the Membership Rules must continue to maintain their registration as a mutual fund dealer and comply with applicable securities legislation and rules.

### **Portfolio Managers**

Firms registered as advisers in the category of portfolio manager act on behalf of both institutional and private high net worth clients pursuant to investment management agreements. Registration as a portfolio manager permits registrants to manage the investment portfolio of clients through discretionary authority granted by one or more clients giving discretion to the portfolio manager to manage assets. According to the comments received during the MFDA recognition comment process, the reasons that a portfolio manager would seek registration as a mutual fund dealer are:

- a) it has prospectus-qualified its pooled funds to enable it to manage all of a client's assets, including those which might not meet a given jurisdiction's exemption thresholds for investing in securities without a prospectus; or
- b) it sells these mutual funds directly to the public.

Some portfolio managers have commented that if required to become a member of the MFDA, the rules of the MFDA would make it difficult or impossible to comply with the terms of the account management agreements they have with their clients. Most notably:

- a) the assets under administration fee model adopted by the MFDA would assess fees based on all relevant assets of a given portfolio manager rather than being limited to those assets related to sales for which mutual fund dealer registration is required; and
- b) the draft rules of the MFDA prohibit discretionary trading by members.

Portfolio managers have suggested that the regulators should consider providing an exemption from the Membership Rules or exemptions from certain of the MFDA rules.

Staff are of the view that, to the extent that a portfolio manager is selling its pooled funds (whether or not prospectus qualified) to clients

for whom they have fully managed accounts governed by the terms of an investment management agreement, it may be appropriate for the portfolio manager to be granted an exemption from the requirement to obtain registration as a mutual fund dealer. A portfolio manager exempted from registration would not be required to become a member of the MFDA.

Registrants making such an application should explain the reasons why they are registered as mutual fund dealers and describe the full extent of their trading activities. Applications will be considered on a case-by-case basis by the applicable regulator. Staff will likely recommend relief from the registration requirements in circumstances where the portfolio manager confirms the nature of their trading activities is such that all clients receiving such fund securities do so pursuant to a discretionary account agreement with the portfolio manager. Staff would likely recommend a condition that such relief expire after a specified limited period after the coming into force of a rule related to pooled funds managed by portfolio managers.

#### **Fund Managers and Portfolio Managers Selling Directly to the Public**

Where a fund manager or a portfolio manager is selling mutual funds pursuant to a prospectus directly to the public, it is appropriate for that registrant to be registered as a mutual fund dealer and to be subject to the Membership Rules.

With respect to exemptions from certain MFDA rules, MFDA staff have noted the difficulties inherent in attempting to regulate only a portion of the assets administered by a member and therefore exemptions from the relevant MFDA rules may not be feasible. As a result, registrants concerned about the impact of MFDA rules upon their business may wish to consider the advice of the Ontario Securities Commission noted in the Notice of Rule 31-506 SRO Membership - Mutual Fund Dealers at (2000) 23 OSCB 7015<sup>1</sup> - namely, changing their business structure by creating a subsidiary to carry on their mutual fund distribution business, surrender their existing registration as mutual fund dealers and register the subsidiary instead. The subsidiary would then be required to be a member of the MFDA and subject to all of its rules.

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<sup>1</sup> This notice can be viewed on the OSC website, [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

Please let me know if you have any additional questions or concerns about the matters outlined in this letter.

Yours truly,

Ross P. McLennan  
Director  
Registration

cc: CSA staff noted and MFDA working group  
John Mountain (IFIC)  
Larry Waite (MFDA)  
Mark Gordon (MFDA)