Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

Summary of Comments Regarding IIROC Exemption from Upgrade Requirement/Elimination of Upgrade Requirement

Background

In November 2013 the Board of Directors of the Investment Industry Regulatory Organization of Canada ("IIROC") granted an exemption from the requirement that mutual fund dealing representatives licensed with IIROC Members become fully qualified as investment dealing representatives within 270 days of the start of employment with the IIROC firm (the "Upgrade Requirement"). Since the inception of the MFDA, the Upgrade Requirement has reflected the separate regulatory regimes of investment dealers and mutual fund dealers, including different proficiency qualifications for dealing representatives of each kind of dealer. The effect of the exemption would have been to permit IIROC Members to employ mutual fund dealing representatives without requiring them to complete the Canadian Securities Course or satisfy further proficiency or training requirements prescribed by IIROC. Attached as "Appendix A" is a summary of the regulatory history and background of the Upgrade Requirement.

In January 2014, recognizing the IIROC exemption raised significant public policy matters, the CSA requested that the IIROC exemption order be suspended so that the CSA, IIROC and the MFDA could have an appropriate dialogue as to the consequences of such an exemption. In the summer and early fall of 2014, MFDA staff engaged in broad-based consultations with MFDA Members through a written Member survey, a series of focus groups and one-on-one meetings with Members. A total of 80 Members participated in the consultations through one or more of these methods. For the purposes of the MFDA's consultation and based on the responses received, the membership was divided into two broad categories: (1) single platform dealers and dual platform dealers. Of the 101 MFDA Members, 26 are "dual platform" Members who are affiliated with an IIROC Member and the remaining 75 are single platform Members.

The MFDA and IIROC submitted reports to the CSA in September 2014 summarizing the comments received from our respective Members. In March 2015, the IIROC Board of Directors revoked the exemption order on consent of the applicant.

The comments from MFDA Members received through the consultation are summarized below under the following categories: Dealer Impact; Client/Public Impact; Member Views on Exemption/Rule Amendment removing the Upgrade Requirement and Impact on the Regulatory Structure.

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1. Dealer Impact

The following comments were made on the impact to MFDA Members of the IIROC exemptive relief order, further such orders or the elimination of the Upgrade Requirement by way of a Rule amendment:

Impact on Mutual Fund Dealer Channel

- Most single platform mutual fund dealers believed they would either go out of business or be forced to consolidate with an IIROC firm.

- A possible reduction in the number of MFDA Members would reduce the assessment base of the MFDA and likely increase the MFDA fees of the remaining Members to an unreasonable level.

- Many advisors with smaller books of business servicing smaller value clients would not be able to operate on the IIROC platform and would surrender their license.

Impact on Dealer Operations

Comments from dual platform Members on the impact of the exemption to their operations and costs varied:

- Some identified opportunities for cost savings and operational efficiencies while others did not see obvious cost savings opportunities or efficiencies for their particular firms.

- A few noted challenges and costs associated with moving their MFDA business to the IIROC platform (e.g. system conversion, changes to policies and procedures, forms and client disclosure documents).

Comments from single platform Members on the impact of the exemption to their operations were generally consistent:

- Their business model would not bear the costs of moving to an IIROC platform.

- Most would either need to become introducing dealers to IIROC carrying dealers, sell their business to an IIROC Member or go out of business.

Competitiveness

- Many dual platform members would need to apply for, or consider applying for, a similar exemption if made available otherwise they may be at competitive disadvantage relative to other dual platform firms that have it.

- A few dual platform Members believed an exemption would allow them to become more competitive with IIROC Members and their bank-owned competitors.

- Most single platform Members believed that the exemption would put them at a competitive disadvantage by allowing dual platform MFDA Members and IIROC Members to grow their business by recruiting their mutual fund representatives.

- Most Members believed that the exemption would accelerate industry consolidation.

2. Client/Public Impact

The following comments were received on the impact to clients and the public of the IIROC exemptive relief order, further such orders or the elimination of the Upgrade Requirement by way of a Rule amendment:

- Increased ease of transitioning clients to IIROC firm.

- Reduced client confusion as a result of being able to deal with one corporate entity for all products and services.

- Potential access by clients to broader product shelf and services.

- Potential disruption to clients in transitioning to IIROC platform caused by need to repaper client accounts/re-register client assets from client to nominee name.

- Some Members could not identify any significant positive impact for clients.

- Loss of access to advice resulting from disappearance of smaller firms that service smaller client accounts.

- Loss of access to advice to investors in smaller and remote communities.

- Risk that clients with smaller account sizes will be orphaned because they are not viable on an IIROC platform.

- Reduction in type and level of advice and service for small value clients as a result of industry consolidation and the disappearance of independent dealers.

- Higher cost structures associated with mutual fund firms operating on an IIROC platform that may be passed onto clients.

- Client confusion regarding types of products representatives at IIROC firms can sell.

- Risk of mutual fund restricted representatives at IIROC firms advising and trading beyond limits of registration.

3. Member Views on Exemption/Exemption Process/Rule Amendment removing the Upgrade Requirement

The views of MFDA Members on the IIROC exemptive relief order, further such orders or the elimination of the Upgrade Requirement by way of a Rule amendment included the following:

- A few Members believed an exemptive relief process is a quick process to achieve market and regulatory structure change.

- A few dual platform Members stated they would apply for exemptive relief immediately if made available.

- Most Members with the exception of a few did not support the exemptive relief granted by IIROC or the granting of similar future orders.

- Most dual platform Members would require more information to determine operational impact before deciding to apply for exemption.

- Many dual platform members stated that while they would not actively seek an exemption, they would need to apply for it, or consider applying for it, for competitive reasons if other firms obtained it.

- Confusion was expressed as to the reasons for the exemption.

- General view expressed that cost savings and increasing competitiveness is not an appropriate basis for granting exemptive relief – no unique circumstances.

- Exemptive relief process is not transparent, does not allow for stakeholder input or consideration of all possible issues/implications for regulatory structure, Members, clients and the public.

- Extensive and transparent consultation is required to ensure there are no adverse, unintended consequences.

- Most Members preferred a rule based approach to the exemptive relief process as it would be more transparent and subject to formal review and consultation,

however at the same time, many of these Members noted that neither alternative was preferable at this time. It was recognized that the same regulatory, economic, policy and public interest concerns and considerations would arise through a rule amendment process on this issue.

- Concern expressed that a significant proportion of Approved Persons, clients and assets could move to IIROC on an ad hoc basis without adequate consideration of the impact on the industry regulatory framework as a whole.

4. Impact on Regulatory Structure

The views of MFDA Members with respect to the impact of the IIROC exemptive relief order, further such orders or the elimination of the Upgrade Requirement on the current regulatory structure included the following:

- No specific alternatives to removing the Upgrade Requirement were identified by Members.

- Most Members raised the topic of one SRO as a related issue as opposed to an alternative to removal of the Upgrade Requirement.

- General consensus among Members that current SRO structure is working well and investors are well protected.

- Reconsideration of current SRO structure should be driven by investor protection and regulatory concerns not dealer cost savings or exemptions.

- While several Members raised the issue of an MFDA/IIROC merger, most Members believed that a simple merger of two existing SROs was not appropriate and that there should be a broader discussion that would include consideration of the role of SROs and other registrants that deal with retail public not currently subject to SRO oversight.

- Rethink of current SRO structure should start with blank slate and reflect separate channels and registrant business models.

- If there are to be changes to existing SRO structure, it would be preferable if led by CSA and not done by an IIROC exemption.

- It would not be a good time to undertake a review of SRO structure in light of regulatory changes and new requirements facing the industry – huge undertaking for CSA and an unnecessary distraction and disruption for industry.

APPENDIX A

Regulatory History and Background of Upgrade Requirement

Introduction

1. Ontario regulations and OSC rules[i] in effect prior to the formation of the MFDA precluded mutual fund dealer representatives from being registered as representatives of an investment dealer (s. 124 of Ontario Regulation 1015 (R.R.O 1990) and OSC Rule 31-502 as it was in effect (until the amendments effective August 17, 2000)). The result of this regulatory approach was that an investment dealer could only employ representatives who met the proficiency requirements applicable to trading or advising in the type of securities that the dealer was permitted to trade or in respect of which it could advise.

2. OSC Rule 31-502 was amended on August 17, 2000, following a four year consultation period, to permit representatives restricted to mutual fund sales to be employed within investment dealers but only for a period of 270 days (i.e. 9 months), during which time such mutual fund representatives are required to complete the necessary proficiency requirements[ii] applicable to an investment dealer representative (the "Upgrade Requirement").

3. In addition to the above restrictions, the Ontario rules also limited the number of mutual fund representatives which could be employed by an investment dealer at any one time to the lesser of 100 and 5% of the total number of representatives. Such restriction was removed in 2007. At the time, the OSC commented as follows:

> "The Commission has considered the suggestion to remove the 270 Day Requirement and decided not to do so at this time. The purpose of the temporary status of 'restricted representative' is to facilitate the transition of newly hired IDA salespersons who already have qualifications appropriate to the sale of mutual funds into fully-qualified IDA salespersons. The effect of combining [the removal of the cap on the number of mutual fund only salespeople permitted at full service dealerships] with the removal of the 270 Day Requirement would be to change the purpose of having restricted representatives at IDA members. It would become possible for individuals hired as restricted representatives to remain so indefinitely, allowing IDA members to have unlimited numbers of representatives qualified only to deal in mutual funds. However, as our securities regulatory system is presently structured, it is the role of the MFDA to act as the self-regulatory organization (the SRO) for firms and individuals whose dealer activities are limited to sales of mutual funds. The consequences of removing the 270 Day Requirement would be to permit a business model that would be inconsistent with the design of the existing regulatory system. Also, if a sufficient number of the MFDA's larger members were to transfer their operations to IDA affiliates, the ongoing viability of the MFDA

> could be undermined. We therefore believe that it is appropriate to maintain the 270 Day Requirement until such time as the roles of these SROs in our regulatory system is re-evaluated." (Notice of Amendment to OSC Rule 31-502 March 9, 2007)

4. As part of registration reform, the Ontario and New Brunswick rules were repealed as a result of the adoption of national rules (NI 31-103) on September 28, 2009. The national rules did not include the Upgrade Requirement as such requirement was added to the IIROC Rules on the same day that NI 31-103 became effective. The Upgrade Requirement was incorporated in IIROC Rule 18.7 to "develop uniformity of practice across the country".

5. Under current IIROC rules, mutual fund representatives who are employed by an investment dealer are required to meet the proficiency qualifications of an investment dealer registered representative within 270 days of the start of employment. In addition, they must complete the 30 day or 90 day training program (as applicable) within 18 months of obtaining IIROC approval in order to become fully licensed to deal in and/or advise on securities generally. During the 270-day period, the representative operates under a license restricted to handling of mutual fund securities only.

6. As a result of current rules, investment dealers that wish to include mutual fund representatives within their corporate group are required to either (i) ensure that the representatives satisfy the Upgrade Requirement or (ii) cause a separate legal entity (often an affiliate of the investment dealer) registered as a mutual fund dealer to employ such representatives.

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[i] Corresponding rules were also in effect in New Brunswick.

[ii] The proficiency requirements consisted of completion of the Canadian Securities Course and the Conduct and Practices Course or the Partners', Directors' and Senior Officers' Qualifying Examination.