



MUTUAL FUND DEALERS ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DES COURTIERS DE FONDS MUTUELS  
**ANNUAL REPORT 2005**

RAISING THE STANDARD OF REGULATION IN CANADA

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## MFDA VISION

To enhance investor protection and strengthen public confidence in the Canadian mutual fund industry.

## MFDA MISSION STATEMENT

The MFDA is the recognized self-regulatory organization for mutual fund dealers in Canada.

The MFDA enhances investor protection and strengthens public confidence by mandating, monitoring compliance with, and enforcing rules and practices to ensure high standards of conduct by its Members.

Through consultation with stakeholders, the MFDA strives to achieve measured and common sense responses in performing its regulatory mandate.



## MESSAGE FROM THE CHAIR OF THE BOARD

I am pleased to present the 2005 Annual Report for the Mutual Fund Dealers Association of Canada for the fiscal year ending June 30, 2005.

This is the MFDA's first Annual Report.

This Annual Report marks a milestone in the construction phase of the MFDA as the national self-regulatory organization for the distribution side of the Canadian mutual fund industry. We are regulating Members and their sponsored Approved Persons in all provinces and territories of Canada, including Quebec, where we have entered into a Cooperative Agreement with the Autorité des marchés financiers to coordinate our regulatory efforts.

A significant amount of work has been completed to date, including the development and implementation of a Rulebook tailored for the mutual fund dealer industry, the formalization of regular on-site Member compliance reviews and financial examinations, the investigation of client complaints and the conduct of disciplinary proceedings.

Effective July 1, 2005 we introduced a new Canadian investor protection plan for clients of mutual fund dealers. The MFDA Investor Protection Corporation fund provides clients with up to \$1 million coverage respecting client assets held by a mutual fund dealer in the event of a dealer's insolvency.

I would like to take this opportunity to thank the members of the Board of Directors whose term of office have been completed for their significant contribution to the corporate governance activities of the MFDA. Their experience and insights ensured that Board decisions reflected a balance between industry and public interests.

I would also like to acknowledge the efforts of MFDA staff over the years and thank them for their many achievements in establishing the MFDA as a strong regulator in Canada.

As we move forward, we will continue to explore ways to build upon our successes to date as a national regulator in Canada's dynamic capital market.



Robert J. Wright, C.M., Q.C.  
Chair, MFDA Board of Directors



Robert J. Wright, C.M., Q.C.  
Chair of the Board

## MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER



Larry M. Waite  
President and Chief Executive Officer

The MFDA is a not-for-profit corporation responsible for regulating 179 mutual fund dealers in Canada and their 75,000 sponsored Approved Persons. These Member firms account for approximately \$260 Billion of the estimated \$540 Billion of client assets under administration in the Canadian mutual fund industry.

The MFDA is not a government agency. However, securities commissions in a number of jurisdictions across Canada have formally recognized the MFDA as a self-regulatory organization (“SRO”) under their respective securities laws. As well, a number of securities commissions have, to the extent permitted under their respective securities laws, passed local rules requiring mutual fund dealers to apply for, and become a Member of the MFDA if they wish to carry on business.

Through the process of becoming a Member of the MFDA, each mutual fund dealer contractually agrees to abide by, and comply with, MFDA By-laws and related regulatory instruments enacted by the MFDA Board of Directors from time to time. The MFDA By-laws include a comprehensive framework for conducting disciplinary hearings to address non-compliance by Members and Approved Persons.

The MFDA performs no industry representation or trade association functions for its Members or Approved Persons. The majority of the MFDA’s 101 staff in Toronto, Calgary and Vancouver, are actively involved in compliance and enforcement activities, each of which has a strong investor protection orientation. Operationally, the MFDA’s regulatory activities are organized into the following departments:

- Compliance
- Enforcement
- Policy
- Membership Services
- Corporate Secretary

Details respecting each of these departments are set out in this Annual Report.

The principal governance structure at the MFDA is the Board of Directors, which is comprised of an equal number of Public and Industry Directors, along with the President and Chief Executive Officer. The Chair of the Board of Directors is presently a Public Director. There is active Public Director participation on Board Committees. In particular, each of the Audit, Governance and Regulatory Issues Committees are required to be chaired by a Public Director.

There is also strong public representation on MFDA Regional Council Hearing Panels. Hearing Panels are separate and distinct from the Board of Directors and have responsibility for impartially adjudicating disciplinary proceedings in respect of MFDA Members and Approved Persons, as set out in the MFDA By-laws. All 3-person Hearing Panels established from time to

time are chaired by a public representative who is either a retired judge or a lawyer in Canada. The other two members of each Hearing Panel are individuals with securities industry experience, and in many cases are representatives of Member firms.

The MFDA works closely with securities regulatory authorities across Canada to enhance regulation in Canada through such means as reporting on market practices observed during our compliance reviews and participating actively with the Canadian Securities Administrators on policy projects. The MFDA is an active member of a number of information-sharing bodies, including the Securities Enforcement Review Committee and the RCMP's Integrated Market Enforcement Teams, whose work is directed at addressing investor protection and market integrity matters.

The MFDA is looking forward to meeting future challenges.

With the introduction of our new investor protection fund for clients of mutual fund dealers now completed, we will focus regulatory attention on the importance of establishing broader investor protection across the entire mutual fund industry.

There has been a proliferation of new and innovative financial products over the past few years targeting retail investors. We will continue to assist regulators in all sectors by sharing our market knowledge with a view to developing appropriate regulatory action to enhance investor protection and public confidence in our markets.

The MFDA will continue to approach its responsibilities as Canada's national regulator of the distribution side of the mutual fund industry in a firm, fair and transparent manner. This initial Annual Report marks an important step toward this goal and I hope it will be of benefit to all readers.



Larry M. Waite  
President and Chief Executive Officer

## HISTORICAL BACKGROUND LEADING TO THE ESTABLISHMENT OF THE MFDA

The MFDA was established in mid-1998 at the initiative of the Canadian Securities Administrators (“CSA”) in response to the rapid growth of mutual funds distributed in Canada from approximately \$40 Billion to \$400 Billion, and the recognition among securities regulatory authorities that the mutual fund industry and investors would benefit from more effective regulation and oversight. There was concern that the regulatory structures for the mutual fund distribution business were inadequate.

These concerns prompted the Ontario Securities Commissioner, Glorianne Stromberg’s January 1995 report, “Regulatory Strategies for the Mid-90’s: Recommendations for Regulating Mutual Funds in Canada” (the “Stromberg Report”).

The Stromberg Report addressed what was called “The Perception of the Securities Regulatory System” in Canada and identified a number of deficiencies in the regulatory structure for the mutual fund industry, including: multiplicity of jurisdictions; lack of coordination; lack of trained regulatory personnel; lack of technical expertise; high cost of compliance; slow filing times, and slow policy initiatives.

The CSA responded to the Stromberg Report by inviting a group of industry leaders and representatives to comment and make recommendations in respect of the Stromberg Report. This group, the Investment Funds Steering Group, submitted a report to the CSA in November 1996 entitled “The Stromberg Report: An Industry Perspective”.

The CSA then established priorities reflecting recommendations made in the Reports, including those specifically relating to the regulation of mutual fund dealers.

One of the CSA’s high priorities was the establishment of a national self-regulatory organization to regulate mutual fund dealers and, potentially all dealers and distributors of securities or other financial products. It was acknowledged that the business and regulatory risks associated with market intermediaries (such as securities dealers) who distribute and deal in a wide range of financial products and services (including underwriting and investing client capital) differed from those who restrict their businesses largely to the distribution of mutual funds. It was recognized that separate self-regulatory structures would likely be required for mutual fund dealers and for securities dealers — which handle a wider range of financial products and services.

In 1997, the CSA requested that the mutual fund industry participate in the development of a self-regulatory organization. The CSA initiated discussions with the Investment Dealers Association of Canada (“IDA”) and the Investment Funds Institute of Canada (“IFIC”) to facilitate the formation of a self-regulatory organization whose mandate would be the direct regulation of distributors of mutual funds.



Staff of MFDA Pacific Regional office in Vancouver, B.C.

The result of these discussions was an agreement between the CSA, the IDA and IFIC for the joint sponsorship and development of the Mutual Fund Dealers Association of Canada as a self-regulatory organization for mutual fund dealers in Canada.

In April 1998, the MFDA appointed its first Board of Directors comprised of 21 members with equal representation from the IDA, IFIC and the public.

Reflecting its mandate as a national SRO, in May 2001 the MFDA opened its Pacific Regional Office in Vancouver and in September 2001 the Prairie Regional Office in Calgary opened.

In 2001, the MFDA was recognized as a self-regulatory organization by the following securities commissions:

Alberta Securities Commission	April 10, 2001
British Columbia Securities Commission	February 9, 2001
Nova Scotia Securities Commission	November 26, 2001
Ontario Securities Commission	February 6, 2001
Saskatchewan Financial Services Commission	February 13, 2001

Each of these securities commissions imposed terms and conditions on the recognition of the MFDA that address the MFDA's role as a financial market regulator. They, along with the Manitoba Securities Commission, adopted local Rules that required mutual fund dealers to become Members of the MFDA. The Securities Administrator in New Brunswick made MFDA membership a term and condition of mutual fund dealer registration in that Province. In all other jurisdictions (with the exception of Quebec), an application for formal recognition of the MFDA as an SRO has been made or is not possible having regard to specific limitations in the local securities legislation.

In the Province of Quebec, the MFDA has entered into a Cooperative Agreement with the Autorité des marchés financiers ("AMF") and the Chambre de la sécurité financière ("CSF"). In light of the similar regulatory activities and functions of the MFDA, the AMF and the CSF, the Cooperative Agreement sets out general principles on which the MFDA, AMF and CSF will cooperate in the regulation of MFDA Members and their Approved Persons both in Quebec and the rest of Canada. It provides for information-sharing and the conduct of prudential and sales compliance examinations in Quebec, outlines general procedures for complaint handling and enforcement, and sets out the goal of rule harmonization and joint policy development.

Commencing in 2001, the MFDA received approximately 250 applications for membership. The applicants were operating firms already registered as mutual fund dealers by securities commissions across Canada. The MFDA accepted its first Members in October 2001. Over the ensuing year and a half, the primary focus for the MFDA was reviewing and processing membership applications.

## MFDA MEMBERSHIP INFORMATION

MFDA Members vary in size, geographical location of operations, and business conducted. Many Members and their Approved Persons are involved in the sale of financial services and instruments other than mutual funds. The range of other products includes:

- Insurance products, such as life insurance and segregated funds,
- Limited market and exempt products sold in reliance of applicable registration and prospectus exemptions set out in securities legislation, and
- Guaranteed Investment Certificates.

MFDA Members and their Approved Persons may also engage in financial planning activities for clients.

There are four principal categories of MFDA Member summarized as follows:

Category	MFDA Capital Requirement	Key Attributes
Level 1 Dealer	\$25,000	Member is an introducing dealer and is not a Level 2, 3 or 4 Member.
Level 2 Dealer	\$50,000	Member does not hold client cash, securities or other property (i.e. Member does not operate a trust account and conducts business in client name only).
Level 3 Dealer	\$75,000	Member does not hold client securities or other property – except client cash in a trust account.
Level 4 Dealer	\$200,000	All other Members (including a Member that acts as a carrying dealer).

The following Tables provide comparative statistical information respecting MFDA Members as at 2002, the year in which the MFDA received Members, and August 2005.

**Table 1** MFDA Membership Profile

	2002	2005
Number of Members	220	179
Number of Approved Persons	55,000	75,000
Assets Under Administration of all Members	\$224 B	\$262 B
Total Industry Assets Under Administration	\$400 B	\$547 B

**Table 2** Location of Member Head Offices

	2002	2005
Ontario	145	120
British Columbia	20	16
Quebec	14	14
Alberta	11	9
Manitoba	12	8
Saskatchewan	8	6
Nova Scotia	6	3
New Brunswick	4	3
Total	220	179

**Table 3** Member AUA per Head Office

	2002	2005
Ontario	\$ 164.3 B	\$ 187.3 B
Manitoba	\$ 38.2 B	\$ 48.6 B
British Columbia	\$ 9.5 B	\$ 12.4 B
Quebec *	\$ 3.1 B	\$ 5.8 B
Saskatchewan	\$ 6.1 B	\$ 4.3 B
Alberta	\$ 1.9 B	\$ 2.8 B
New Brunswick	\$ 225 M	\$ 393 M
Nova Scotia	\$ 567 M	\$ 198 M
Total (rounded)	\$ 224 B	\$ 262 B

\* The figures attributed for Quebec do not reflect Members' Assets under Administration in the Province of Quebec. Rather, they reflect the Assets under Administration reported to the MFDA by Members with a Head Office in the Province of Quebec in respect of business conducted through Branch Offices outside Quebec. They are reported on an aggregate basis without reference to any specific province(s) and are included in Table 3 for completeness.

**Table 4** Number of Members by AUA Size

	2002	2005
\$100 Million and Under	122	84
\$101 Million to \$500 Million	60	50
\$501 Million to \$1 Billion	10	12
Over \$1 Billion	28	33
Total	220	179

**Table 5** Number of Members by Firm Size

	2002	2005
10 Approved Persons or Fewer	101	78
11 to 100 Approved Persons	74	54
101 to 500 Approved Persons	20	27
501 to 1,000 Approved Persons	10	6
Over 1,000 Approved Persons	15	14
Total	220	179

In December 2003, the MFDA completed a review of its governance structure. The size of the Board of Directors was reduced from 21 to 13 members and the percentage of participation on the MFDA Board by Public Directors was increased from 33% to 50%. As a result, the 13-member MFDA Board is comprised as follows:

- Six Public Directors,
- Six Industry Directors (five of whom must be officers or employees of a Member), and
- President and Chief Executive Officer.

The MFDA adopted a more stringent definition of “Public Director” in its By-laws which ensures that all corporate decisions properly reflect a balance between industry and public interests.

Diversity criteria were formalized to ensure that the Board of Directors reflects geographical and Member diversity. At least four Directors must represent regions outside Central Canada (Ontario and Quebec) which ensures a national character for all Board decisions.

The following staggered terms of office were introduced to contribute to orderly succession and effective transfer of institutional knowledge:

- 3-year term of office for Public Directors (to a maximum of 2 successive terms), and
- 2-year term of office for Industry Directors (to a maximum of 3 successive terms).

The Chair of the Board of Directors can be either an Industry or a Public Director and is presently a Public Director. Three of the MFDA’s Board Committees (Audit, Governance and Regulatory Issues) are required to be chaired by a Public Director.

## BOARD OF DIRECTORS AND COMMITTEE MEMBERSHIP AS AT JUNE 30, 2005

### PUBLIC DIRECTORS



**Robert J. Wright, c.m., q.c., Chair**  
Deputy Chairman  
Teck Cominco Limited  
Toronto, Ontario



**Robert B. MacLellan**  
Partner  
Burchell MacDougall  
Truro, Nova Scotia



**Martin L. Friedland, c.c., q.c.**  
Professor of Law Emeritus  
and University Professor  
University of Toronto  
Toronto, Ontario



**Janet K. Pau**  
Chartered Financial Analyst  
Vancouver, British Columbia



**William D. Grace, FCA**  
Corporate Director and Consultant  
Edmonton, Alberta



**Irene A. Seiferling**  
Principal  
Board Dynamics Consulting  
Saskatoon, Saskatchewan



**Larry M. Waite**  
President and Chief Executive Officer  
Mutual Fund Dealers Association of Canada  
Toronto, Ontario

## INDUSTRY DIRECTORS



**W. David Wood, Vice-Chair**  
Executive Vice-President and  
Chief Administrative Officer  
National Bank Financial  
Montreal, Quebec



**Stephen J. Geist**  
President  
TD Mutual Funds  
Toronto, Ontario



**George Aguiar**  
President and Chief Executive Officer  
GP Capital Corporation  
Toronto, Ontario



**Peter W. Glaab**  
Chair  
Clarica Investco Inc., a subsidiary of Sun Life  
Assurance Company of Canada  
Waterloo, Ontario



**Timothy Calibaba**  
Director  
Berkshire TWC Financial Group  
Burlington, Ontario



**The Honorable Thomas A. Hockin**  
President and Chief Executive Officer  
Investment Funds Institute of Canada  
Toronto, Ontario

### AUDIT COMMITTEE

William D. Grace, FCA *Chair*  
Stephen J. Geist  
Janet K. Pau

### GOVERNANCE COMMITTEE

Martin L. Friedland, C.C., Q.C. *Chair*  
George Aguiar  
W. David Wood  
Robert J. Wright, C.M., Q.C.

### EXECUTIVE COMMITTEE

Robert J. Wright, C.M., Q.C. *Chair*  
George Aguiar  
William D. Grace, FCA  
W. David Wood

### IPC COMMITTEE

Robert J. Wright, C.M., Q.C. *Chair*  
George Aguiar  
Timothy Calibaba  
Stephen J. Geist  
Peter W. Glaab  
Robert B. MacLellan

### REGULATORY ISSUES COMMITTEE

Robert B. MacLellan *Chair*  
George Aguiar  
Stephen J. Geist  
Thomas A. Hockin  
Irene A. Seiferling

## BOARD COMMITTEE MEMBERSHIP

## REGIONAL COUNCILS AND HEARING PANELS

### REGIONAL COUNCILS

The MFDA has four Regional Councils, which are separate and distinct from the Board of Directors, corresponding to the following geographic regions: Atlantic, Ontario, Prairie and Pacific.

Each Regional Council is comprised of the following individuals:

- Elected representatives of Members, resident in the applicable Region,
- *Ex officio* representatives,
- Appointed Public representatives, who are either retired judges or practicing lawyers, and
- Appointed Industry representatives, who are individuals with securities industry experience and retired from the industry or not associated with a Member.

The principal duties of the Regional Council in each Region are:

- The conduct of hearings by Hearing Panels created from among the Regional Council, and
- The consideration of policy matters relevant to the MFDA.

### HEARING PANELS

MFDA disciplinary proceedings commenced by MFDA enforcement staff against a Member or Approved Person in a Region are conducted before an independent, impartial Hearing Panel. All Hearing Panels are comprised of three Regional Council representatives: one Public Representative and two Industry Representatives.

The Public Representative, who serves as the Chair of each Hearing Panel, is either a retired judge or a practicing lawyer in Canada. This ensures that all MFDA disciplinary proceedings are conducted in accordance with the highest standards of procedural fairness.

MFDA Regional Council Hearings are conducted in public.

Information respecting the Regional Council Hearings is reported to the CSA, disseminated by news release to the media and posted to the MFDA website. Arrangements are in place to ensure that Hearings information is published in the *Ontario Securities Commission Bulletin*.

The MFDA Rules of Procedure, which prescribe procedures for the conduct of hearings and appeals, were approved by the Board of Directors in June 2004. They were published and announced in an MFDA Bulletin and are posted on the MFDA website.

The first MFDA Regional Council Hearing took place in December 2004. Details respecting MFDA Hearings are set out in the Enforcement Section of this Annual Report and can also be found on the MFDA website.

# FAIR

The MFDA enhances investor protection and strengthens public confidence by mandating, monitoring compliance with, and enforcing rules and practices to ensure high standards of conduct by its Members.

## MFDA REGULATORY OPERATIONS

MFDA regulatory operations are organized among the following Departments:

- Compliance
- Enforcement
- Policy
- Membership Services
- Corporate Secretary

### COMPLIANCE

Compliance activities are strongly aligned with investor protection and market integrity objectives, which are advanced through a variety of means, including:

#### A Member Education

The compliance review process, which involves Compliance staff attending at the premises of a Member for a number of days, affords an excellent opportunity for representatives of the Member to ask questions and for Compliance staff to explain requirements. Based on reviews conducted to date, it is clear that these interactions have resulted in better practices and procedures at firms, with consequential benefits for clients. It is noteworthy that prior to the establishment of the MFDA, the majority of mutual fund dealers had never been subject to an on-site compliance review by securities regulators.

#### B Compliance Process

The MFDA performs on-site examinations of Members to monitor compliance with both sales practices and financial requirements. Members are required to submit monthly and annual financial filings allowing Compliance staff to monitor for capital adequacy of the Member and identify irregular financial trends at an early juncture, thereby affording an opportunity for the MFDA to take appropriate action promptly. Such action could include prohibiting the Member from paying dividends or other discretionary amounts to its officers or shareholders, each of which have a strong investor protection impact. Sales practice issues identified during an examination require timely and appropriate resolution by the member. Where significant, they may result in a referral to the Enforcement Department. Early identification of serious problems is beneficial in minimizing ongoing or future harm to investors.

#### C Examination Cycles and Benchmarks

The MFDA undertook to the Canadian Securities Administrators to examine all of its Membership using a comprehensive examination program within three years of admitting its first Members. Examinations began in 2003 and the first cycle of examinations is expected to be completed by December 2005. The MFDA has developed a risk-based approach to examination scheduling for future examinations.



Membership Services and Compliance staff of MFDA Toronto office

The MFDA has established, and has been meeting, a benchmark for examination reports to be issued within 15 weeks of completion of fieldwork for 60% of its membership and within 26 weeks for the remaining Members.

MFDA Members are required to make monthly financial filings using a web-based Electronic Filing System, developed by MFDA staff and introduced in November 2003 and made mandatory in January 2005.

Level 4 Members are those mutual fund dealers which have structured their operations to allow them to hold client cash, securities or other property. The MFDA has 44 Level 4 Members and the Compliance Department performs an on-site financial examination for Level 4 Members annually.

#### D Recurring Issues or Practices

The Compliance Department, through its reviews, is active in identifying recurring or new issues or practices. The Compliance Department also undertakes other initiatives, including Member questionnaires, to gather information on industry issues and practices. This information is shared with Policy and Enforcement staff to identify whether modifications to the MFDA Rulebook might be appropriate or whether some other guidance might benefit Members – such as the issuance of a Notice or Bulletin.

#### E Referral of Issues to Other Regulators

The Compliance Department shares information actively with securities commission staff. Issues that are outside the jurisdiction of the MFDA are often identified during compliance reviews and this information is provided to appropriate agencies for their follow-up.

## COMPLIANCE STATISTICS

**Table 6** Compliance Examinations by Province (as at September 2005)

	Head Office	Branch	Total
Ontario	118	88	206
British Columbia	16	45	61
Alberta	9	31	40
Manitoba	9	7	16
Saskatchewan	7	8	15
Quebec	9	0	9
Nova Scotia	4	4	8
New Brunswick	2	3	5
Newfoundland	0	1	1
Total	174	187	361



Enforcement staff of MFDA  
Toronto office

## ENFORCEMENT

The Enforcement Department operates on several general principles:

- Actions are firm, fair and transparent.
- Members and Approved Persons are afforded an opportunity for input before a decision is made on disciplinary action, except in urgent cases involving potential public harm.
- In all cases, the level of supervision by the Member and its Approved Persons will be part of the review.
- Cases are reviewed proactively, with a view to identifying possible associated misconduct and assessing root causes.
- The Enforcement Department works on a cooperative basis with the Compliance and Policy Departments to refer cases and issues where appropriate.
- The Enforcement Department works on a cooperative basis with Enforcement staff at securities commissions, other self-regulatory organizations and police agencies.

The Enforcement Department is organized into four main groups:

### Case Assessment

This group responds to public inquiries and complaints and conducts initial case assessments. The Case Assessment group escalates cases to Investigations where there are grounds to believe that there has been a substantial breach of MFDA requirements, or where the matter is sufficiently complex to require a more extensive review by an investigator. This group became operational in November 2002.

### Investigations

This group conducts in-depth reviews of cases, which includes gathering documentation, conducting interviews, analyzing cases and preparing reports and recommendations. The group also coordinates investigation activity with other regulatory and law enforcement agencies. The group began referring cases to the Litigation group in 2004.

### Litigation

This group assesses completed investigation cases and is responsible for commencing disciplinary proceedings before Hearing Panels of Regional Councils, where appropriate. This group became fully operational in December 2004.

### Enforcement Policy Counsel

Enforcement Policy Counsel develops written procedures and standard form document precedents, maintains and revises operational manuals, keeps records of research and other work product to maintain knowledge management, and coordinates and maintains records of departmental training.

## A Investor Contact

The Case Assessment group receives inquiries from investors and others every day. Intake sources include:

- Public complaints
- Complaint referrals from securities commissions and other self-regulatory organizations
- Uniform Termination Notices filed by Members with securities regulators
- Voluntary reporting by a Member
- Settlements
- Police, media and other sources
- MFDA Compliance Department
  - Filing deficiencies
  - Egregious conduct, such as theft, fraud, abusive sales practices and discretionary trading
  - Refusal or failure to provide documents or respond to MFDA requests

The MFDA maintains a toll-free telephone number 1-800-466-6332 which is advertised on the MFDA website and which investors may call on business days between the hours of 8:00 a.m. (Eastern) and 5:00 p.m. (Eastern).

As well, the MFDA website contains information respecting complaint processes. This includes flexibility for an investor to forward a complaint directly from the MFDA website.

Case Assessment staff contact all investors that have forwarded an inquiry to the MFDA. In some circumstances, the matter may be outside the jurisdiction of the MFDA, in which event efforts are made to assist identifying alternative avenues of redress for the investor. This includes informing all investors of the Ombudsman for Banking Services and Investments.

The Case Assessment group informs all investors as to the proposed disposition of their matter i.e. the investor will be informed if the matter is being referred to the Investigations Group.

## B Resolution of Matters

The options for the resolution of cases where some form of regulatory action is warranted include:

- Referral to an external agency
- Referral to the MFDA Compliance or Policy Departments
- Administrative Resolution:
  - Warning Letter
  - Agreement and Undertaking
- Escalation of the file to next stage of Enforcement process (i.e. Investigation or Litigation)
- Closing the file



Staff of MFDA Regional office in  
Calgary, Alberta

## C Enforcement Statistics

For the period July 1, 2004 to June 30, 2005:

### Case Handling

- Case Assessment Group: 683 intake matters  
298 matters opened as Cases
- Investigations Group: 63 matters escalated to Investigations Group
- Litigation Group: 13 matters referred to Litigation Group

### Disciplinary Action\*

- 9 Notices of Hearing Issued (6 of which had the Hearing concluded within the period):
  - 1 Settlement Hearing
  - 5 Hearings
- 59 Warning Letters
- 5 Agreements and Undertakings

\* Litigation Group became operational in December 2004.

## D Enforcement Cases

The following is a summary of noteworthy enforcement cases handled during the period July 1, 2004 to June 30, 2005:

### (a) Investors Group: December 16, 2004 Hearing—Ontario Region

The Hearing Panel approved a Settlement Agreement in which Investors Group acknowledged that it had acted contrary to the public interest by permitting a client to conduct a market timing strategy and failing to implement appropriate measures to protect the relevant funds from associated harm. Investors Group paid a total of \$5.35 million, consisting of a voluntary payment, fine and costs, and provided an undertaking to implement additional governance procedures relating to compliance reporting.

### (b) Robert Roy Parkinson: March 17, 2005 Hearing—Ontario Region

The Hearing Panel found that Parkinson had (i) solicited and accepted from clients a total of approximately \$314,000 and failed to return or otherwise account for these monies (ii) provided false account statements and order forms to clients and (iii) abandoned his business as an Approved Person without notice to his clients or to the Member firm. The following penalties were imposed: (i) permanent prohibition on the authority of Parkinson to conduct securities-related business in any capacity (ii) aggregate fine in the amount of \$375,000 and (iii) costs in the amount of \$7,500.

### (c) Arnold Tonnies: May 16, 2005 Hearing—Prairie Region

The Hearing Panel found that Tonnies had (i) borrowed \$250,000 from two clients to finance his outside business activity (ii) failed to abide by the policies and procedures set

out by his Member firm and (iii) failed to produce for inspection and provide copies of documents requested by the MFDA for the purpose of an investigation. The following penalties were imposed: (i) permanent prohibition on the authority of Tonnie to conduct securities-related business in any capacity (ii) aggregate fine in the amount of \$350,000 and (iii) costs in the amount of \$7,500.

(d) Jawad Rathore: May 31, 2005 Hearing—Ontario Region

The Hearing Panel found that Rathore had (i) engaged in gainful occupation outside the business of the Member firm without so advising the Member and obtaining the approval of the Member firm and (ii) failed to produce for inspection and provide copies of documents requested by the MFDA for the purpose of an investigation. The following penalties were imposed: (i) permanent prohibition on the authority of Rathore to conduct securities-related business while in the employ of, or associated with, any Member firm (ii) aggregate fine in the amount of \$25,000 and (iii) costs in the amount of \$7,500.

(e) Raymond Brown-John: June 7, 2005 Hearing—Pacific Region

The Hearing Panel found that Brown-John had (i) failed to deal fairly, honestly and in good faith with the clients and misappropriated from them approximately \$10,600 (ii) borrowed funds from a client totaling \$67,000 thereby creating a conflict of interest (iii) failed to produce copies of documents requested by the MFDA in the course of an investigation (iv) failed to comply with an agreement made at an interview with the MFDA to provide documentation to the MFDA. The following penalties were imposed: (i) permanent prohibition from conducting securities-related business in any form or capacity (ii) aggregate fine in the amount of \$185,000 and (iii) costs in the amount of \$10,000.

(f) Anthony McPhail: June 9, 2005 Hearing—Ontario Region

The Hearing Panel found that McPhail had (i) failed to produce for inspection and provide copies of documents requested by the MFDA for the purpose of an investigation and (ii) failed to attend at the offices of the MFDA to give information respecting matters under investigation. The following penalties were imposed: (i) permanent prohibition on McPhail from engaging in any securities-related business while in the employ of, or sponsored by, any MFDA Member (ii) fine in the amount of \$50,000 and (iii) costs in the amount of \$10,000.

## POLICY

### Overview

The Policy Department is active in monitoring the effectiveness of MFDA By-Law, Rules and Policies; recommending changes, where appropriate; drafting new or amended By-Laws, Rules and Policies; and drafting Notices and Bulletins to Members to assist them with the interpretation and application of MFDA requirements. In drafting and developing policy, the Policy

Department works with staff of other relevant Departments at the MFDA, specifically Compliance and Enforcement, and staff of the MFDA Regional Offices.

The Department provides consulting, legal, research and drafting support to other MFDA Departments and serves as a sounding board for colleagues in their dealings with day-to-day operations on questions of law and best practice. The Department follows current regulatory and industry developments that have implications for mutual fund dealers and builds relationships with other regulatory organizations through its participation in various committees.

The Policy Department is active in encouraging Members to develop a sound understanding of their responsibilities under the existing By-laws, Rules and Policies with a view to their implementing appropriate compliance procedures and policies. To advance Member education, Policy staff collaborate with Compliance and Enforcement staff on a variety of initiatives, including:

- Member Regulation Forum meetings,
- Participation in educational seminars sponsored by other groups involved in the mutual fund industry, and
- Publication of Notices and Bulletins outlining MFDA staff's interpretation of details in the MFDA Rulebook.

### MFDA Regulatory Instruments

The MFDA regulates through a number of regulatory instruments:

#### By-laws

The By-laws set out the constitution for the MFDA and the general operating structure for the MFDA and its Members, including:

- Powers and duties of the Board of Directors
- Membership eligibility and approval process
- Annual fees payable by Members
- Regional Councils
- Examinations and investigations
- Disciplinary procedures

#### Rules

The Rules set out detailed requirements for Members, including particulars respecting:

- Business structures
- Capital requirements
- Insurance
- Books and records
- Client reporting
- Business conduct

## Forms

The principal MFDA form is the Financial Questionnaire and Report.

## Policies

MFDA Policies set out interpretations and minimum industry standards that expand upon prescriptive requirements that Members are required to comply with.

## Notices

MFDA Notices assist Members and Approved Persons in the interpretation, application of, and compliance with, MFDA By-laws and Rules.

## Bulletins

MFDA Bulletins provide information on general matters of interest to Members, such as:

- Admission of new Members
- Resignation of Members
- Business reorganizations or amalgamations involving Members
- Name changes for Members
- Policy announcements
- Frequently-Asked-Questions summaries
- Current regulatory developments

All of the above instruments are updated regularly on the MFDA website.

MFDA staff take a proactive approach in the development of Rules, By-laws, Policies, and Notices. New regulatory instruments or amendments to existing regulatory instruments may result from:

- Comments, inquiries or Frequently-Asked-Questions from Members;
- Common deficiencies identified during compliance reviews and issues that arise from enforcement activities;
- Applications for exemptive relief received from Members;
- Issues raised by MFDA Policy Committees; and
- Initiatives and projects of other regulators.

In drafting policy, MFDA staff conducts research and reviews practices adopted by other SROs and regulators. Staff also evaluates operational issues that might inform any proposed changes, such as impacts on Members and investors.

MFDA By-laws and Rules are subject to the approval of the MFDA Board of Directors, Members and the recognizing securities commissions.



Policy staff of MFDA Toronto office

### Policy Committee Structure

A key initiative for the MFDA in 2004 was the development and implementation of a three-part committee structure to facilitate Member participation in policy matters. The committee structure consists of the Policy Advisory Committee (“PAC”), the Member Regulation Forum (“Forum”) and Ad Hoc Working Groups.

The PAC was constituted in September 2004 and consists of eight senior industry representatives and the four chairs of the MFDA Regional Councils who serve as *ex officio* members. Members of the PAC are officers and senior employees of MFDA Members. Individuals were selected with a view to ensuring that the PAC is reasonably representative of the diversity of the MFDA membership having regard to the following criteria:

- Regional representation
- Size of business
- Type of business
- Ownership structure

The principal function of the PAC is to act as a sounding board for MFDA staff on policy matters. The PAC provides advice and commentary to MFDA staff on a variety of issues including regulatory and policy initiatives of the MFDA and the CSA, and provides perspectives on various industry trends and practices.

The primary objective of the Forum is to share information with Members. The Forum is also intended to provide MFDA Members with an opportunity to interact with MFDA staff on such matters as current regulatory developments and practices observed during compliance reviews. To date, Forum meetings have been held semi-annually in various cities across Canada to maximize regional participation and access to the Forum by all Members.

Ad Hoc Working Groups will be established by MFDA staff from time to time, as required, consisting of a smaller number of individuals who will participate with MFDA staff in developing recommendations respecting particular policy initiatives.

### MFDA Policy Initiatives for the period July 1, 2004 to June 30, 2005

The following is a summary of key MFDA Member Regulation Notices issued:

- **Referral Arrangements (MR-#0030, Issue Date: September 20, 2004)**—This Notice was issued to clarify the obligations of Members and their Approved Persons with respect to the nature and substance of referral arrangements that are permitted under MFDA Rules.
- **MFDA Rule 1.1.7—Use of Business, Style or Trade Names by Members and Approved Persons (MR-#0032, Issue Date: November 22, 2004)**—This Notice was issued to clarify the MFDA’s requirements with respect to the use of trade names by Members and Approved Persons.

- **Websites of Approved Persons of MFDA Members (MR-#0033, Issue Date: November 22, 2004)**–This Notice reminds Members of the requirement to review websites of their Approved Persons to ensure compliance with MFDA Rules.
- **Recording and Maintaining Evidence of Client Trade Instructions (MR-#0035, Issue Date: December 10, 2004)**–This Notice was issued to remind Members and their Approved Persons of the requirement to record and maintain evidence of client trade instructions for all trades in accordance with MFDA Rule 5.1(b).
- **Compliance Responsibilities (MR-#0037, Issue Date: March 16, 2005)**–This Notice was issued to outline the expectations of the MFDA with respect to the development and operation of an effective compliance function.
- **Outside Business Activities (MR-#0040, Issue Date: May 20, 2005)**–This Notice was issued to clarify the obligations of Members and Approved Persons regarding outside business activities.
- **Automatic Conversion of Deferred Sales Charge to 0% Front-End Load Units Without Client Knowledge or Consent (MR-#0041, Issue Date: June 8, 2005)**–This Notice was issued to address regulatory concerns with certain arrangements entered into by mutual fund managers and MFDA Members and their Approved Persons, which involve the automatic conversion of clients’ units of a mutual fund with a deferred sales charge into units of the same fund carrying a 0% front-end load without client knowledge or consent.

## MEMBERSHIP SERVICES

Membership Services activities at the MFDA include responding to media and public inquiries and maintaining and updating the MFDA website.

During the period July 1, 2004 to June 30, 2005, a total of 2,212 inquiries were handled. The majority of inquiries were received from MFDA Members and generally related to MFDA requirements, as well as other regulatory issues such as registration requirements; the use of the MFDA’s Electronic Filing System; transactions with clients who are resident in countries other than Canada; the use of trade names, and matters related to securities legislation.

## CORPORATE SECRETARY

The Corporate Secretary is an active participant in MFDA corporate governance matters and administers all aspects respecting the activities of Regional Councils, ranging from processes for the election and appointment of representatives to each Regional Council to the coordination and support of all disciplinary hearing-related work by Hearing Panels of the Regional Councils across Canada. The Corporate Secretary functions as the hearing coordinator and registrar for all MFDA disciplinary proceedings and is responsible for maintaining the public file and disseminating information respecting all hearing-related events to the Canadian marketplace.



Corporate Secretary staff of MFDA Toronto office

# TRANSPARENT

Through consultation with stakeholders, the MFDA strives to achieve measured and common sense responses in performing its regulatory mandate.

A top priority for the MFDA in 2004 was the establishment of an investor protection fund for clients of MFDA Members.

In August 2001, the MFDA filed an application with the Canadian Securities Administrators for approval of an investor protection fund established by a separate corporation (MFDA Investor Protection Corporation or “MFDA IPC”), which was published by the CSA for comment in November 2002. Many of the public comments received suggested the MFDA explore the possibility of joining the Canadian Investor Protection Fund (“CIPF”) rather than establish a separate fund.

A special committee of the MFDA Board of Directors was established to consider the options and implications of developing an MFDA investor protection plan or joining the CIPF. In this regard, the special committee requested that a survey be distributed to MFDA Members to assess the implications of each option. The first survey was sent in January 2004 and in April 2004, a second survey was sent to those who did not initially respond. Members indicated concern with capital and insurance increases and with the additional cost associated with the funding of an investor protection plan.

The MFDA Board of Directors considered the responses to the surveys and concluded, subject to certain conditions, that the prospect of MFDA participating in CIPF should be pursued. Accordingly, in the Spring of 2004, discussions were commenced with the board and management of CIPF. Following initial discussions, a formal working group—consisting of representatives of both CIPF and MFDA—was established in May 2004 to study the differences between the MFDA Rules and CIPF Minimum Standards, as well as the general differences in the operations and risks of both mutual fund dealers and investment dealers. Significant differences included capital requirements, client reporting, the assessment base, distribution structures and client versus nominee holdings. At the conclusion of the review process, it was apparent that many of the differences identified between the businesses and risks of MFDA Members and investment dealers could be eventually resolved, but not within the CSA/MFDA timeframe.

In September 2004, after careful consideration of the circumstances, the MFDA Board of Directors decided to proceed with the establishment of the MFDA IPC rather than to pursue participation in CIPF at this time.

The customer loss coverage to be offered by MFDA IPC was to be similar in substance to that of CIPF; namely, all financial products held by an MFDA Member would be eligible for coverage and the amount of coverage per separate account would be up to \$1 million. In order to provide such coverage, the MFDA Board determined that an initial fund containing liquid financial assets of \$30 million would be appropriate.

The application of the MFDA IPC to the relevant members of the CSA was amended and resubmitted for approval on November 12, 2004. The application was published for comment on February 25, 2005 and formal approval of the MFDA IPC was received on May 3, 2005.

The MFDA IPC began offering coverage on July 1, 2005.

A copy of the MFDA IPC coverage policy and brochure is available through a link on the MFDA website.

As part of its terms and conditions of recognition by securities commissions, the MFDA IPC has established a Working Group to review various particulars, including appropriate fund size and assessment methodology. It will present a report to the MFDA IPC Board of Directors in the Spring of 2006, which will in turn file a report to securities commissions by June 30, 2006.

In December 2001, the MFDA and the four other major industries of Canada's financial services sector (banks, life and health insurers, property and casualty insurers and investment dealers) announced the creation of a national ombuds service, the Centre for the Financial Service OmbudsNetwork ("CFSON"). The CFSON is an industry-based, integrated consumer assistance service that builds on existing consumer redress mechanisms by providing a single point of entry for the consumer. By calling CFSON's "1-800" number, clients with complaints about their financial services provider can be referred to the appropriate dispute resolution service.

The contact information for CFSON is 1-866-538-3766 (for assistance in English), 1-866-668-7273 (for assistance in French).

Additionally, the MFDA, IDA and IFIC worked to establish a single ombudsman to deal with customer complaints. In late 2002, this initiative was merged with the Canadian Banking Ombudsman to form the Ombudsman for Banking Services and Investments ("OBSI") to act as an independent dispute resolution service for customers of banks and members of the MFDA, IDA and IFIC.

The contact information for OBSI is 1-888-461-4519.

The MFDA formalized its support of these ombuds service initiatives through an amendment to its By-laws which requires that MFDA Members must:

- Participate in the ombuds service designated by the MFDA, namely OBSI and CFSON;
- Provide their clients with information respecting OBSI and CFSON; and
- Cooperate with, and provide information to, OBSI in connection with their investigations.

The By-law amendments also specify that should a Member not provide information to OBSI or provide false information, then MFDA Enforcement staff may bring a disciplinary action against the Member.

The MFDA, on behalf of OBSI and CFSON, invoices and collects levies from MFDA Members in respect of fees associated with the ombuds services.

MFDA Enforcement staff inform all complainants about the existence of OBSI and provide contact information for OBSI.

## MANAGEMENT DISCUSSION AND ANALYSIS

The financial statements present the results of the MFDA for the fiscal year ended June 30, 2005 with 2004 comparatives and accompanying notes.

### Revenues

The principal source of revenue for the MFDA is Membership fees, which are assessed against Member firms and are calculated to provide sufficient funding to the MFDA to cover its yearly budgeted expenses and also maintain a working capital reserve of approximately three month's expenses.

Membership fees are calculated based upon a formula that takes into account the amount of assets under administration ("AUA") that each Member firm has under its control. Each year, on or before April 15, MFDA Members are required to report their AUA figures as at March 31. AUA figures represent AUA from operations in all provinces other than Quebec and specifically exclude cash, GIC's, limited partnerships, and segregated funds. A Member's reported AUA for the current year is then added to the previous year's reported AUA and an average of the two years is calculated for billing purposes.

The MFDA uses a five-tiered AUA rate schedule as the basis for its billing. Members are billed a set fee amount per \$million of AUA based upon this schedule. The fee rates on this tiered schedule are set in order to provide sufficient funding for the upcoming fiscal year. The MFDA fee payable by a Member is calculated by matching its average AUA figure to this tiered fee schedule. For some Members, a minimum MFDA fee will apply. Each Member's fees for the year are broken down into four equal payments that are invoiced on a quarterly basis.

Other sources of revenue for the MFDA, as contemplated by the MFDA By-laws, include:

- Fines ordered by Regional Council Hearing Panels in connection with MFDA disciplinary proceedings, and
- Costs awarded to the MFDA by Regional Council Hearing Panels at the conclusion of MFDA disciplinary proceedings.

For the fiscal year ended June 30, 2005, MFDA revenues were \$18.3 million (compared to \$14.8 million for the 2004 fiscal year) and expenses were \$14.8 million (compared to \$10.8 million for the 2004 fiscal year). The excess of revenue over expenses for the fiscal year ended June 30, 2005 was \$3.6 million (compared to \$4.0 million for the 2004 fiscal year).

Factors relating to these figures included:

- Continuation of the construction phase of the MFDA's development as a national self-regulatory organization, which involved the hiring of additional staff, principally in the areas of Compliance and Enforcement. The MFDA conducted its hiring on an as-needed basis with

the result that a number of positions were filled at a later time during the fiscal year than originally planned.

- Increased travel for each of the Compliance and Enforcement Departments. Staff in each of these Departments performs regulatory activities at the sites of Member operations across Canada. The Enforcement Department became fully operational during the fiscal year ended June 30, 2005.
- MFDA Regional Councils were established and hearings training was conducted across the country to prepare industry representatives for their responsibilities as members of Hearing Panels.
- The MFDA commenced holding disciplinary hearings before Hearings Panels of Regional Councils across Canada. This resulted in new categories of expenses for the MFDA, including Public Panel Chair compensation, court reporter costs, transcript costs, hearing room rental expenses and associated travel and accommodation for hearings conducted outside Toronto.

### Investor Protection Corporation

The financial statements include separate revenue and expense particulars for the MFDA Discretionary Fund—which is an internally restricted fund established by the Board of Directors to receive monies from the collection of enforcement fines and the return of profits imposed by order of MFDA Regional Council Hearing Panels. Any such sums received by the MFDA are segregated from the MFDA's operational funds. Disbursements from this discretionary account may only be made upon special approval of the MFDA's Board of Directors. During the fiscal year ended June 30, 2005, a total of \$2,650,000 was placed in the Discretionary Fund. Of this amount, \$2,500,000 was directed by the Board of Directors to be contributed to the MFDA Investor Protection Corporation.

The MFDA bills and collects assessments on behalf of MFDA Investor Protection Corporation. From an accounting perspective, these amounts flow through the MFDA balance sheet as an asset to reflect the assessment to be received from Members, with an offsetting liability to the MFDA Investor Protection Corporation to reflect future remittance.

During the fiscal period ended June 30, 2005, the MFDA recovered the start-up costs, in the amount of \$887,672, relating to the establishment of the MFDA Investor Protection Corporation. As at June 30, 2005, the costs recoverable from MFDA Investor Protection Corporation were \$48,940.

## Looking Ahead

In terms of costs facing the MFDA, staffing remains the organization's largest annual expense. As at June 30, 2005, there were 101 staff employed with the MFDA and it is anticipated that by June 2006 the MFDA staff count will be 133 employees. The largest addition to the staff complement will come from the Financial Compliance and Enforcement Departments.

There will be other increased expenses facing the MFDA in the future including Compliance staff travel to Member offices in order to perform compliance reviews and Enforcement staff travel for investigations and other enforcement actions on an as-needed basis. There will also be corresponding Hearing Panel expenses.

In terms of building the MFDA's infrastructure, there are several large projects that will be undertaken in the upcoming year intended to address the workflow needs of the organization. Chief among these projects are a business process management system, a complaints registration and tracking system, and a major upgrade to the MFDA's website that will make it more user friendly and efficient for both Members and the public.

FINANCIALS

## AUDITORS' REPORT

To the Members of  
Mutual Fund Dealers Association of Canada

We have audited the balance sheets of Mutual Fund Dealers Association of Canada ("MFDA") as at June 30, 2005 and 2004 and the statements of revenues and expenses, changes in fund balances and of cash flows for the years then ended. These financial statements are the responsibility of MFDA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of MFDA as at June 30, 2005 and 2004 and the revenue and expenses, changes in fund balances and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Deloitte & Touche LLP  
Chartered Accountants  
Toronto, Ontario  
August 12, 2005

## BALANCE SHEETS

As at June 30

	2005	2004
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash (Note 3)	\$ 4,569,505	\$ 359,927
Membership fees billed in advance (Note 4)	4,588,393	4,510,672
MFDA Investor Protection Corporation assessments billed in advance (Note 5)	1,298,865	–
Other membership receivables	14,700	32,849
Prepaid expenses and other assets	278,491	214,030
	<u>10,749,954</u>	<u>5,117,478</u>
Capital assets (Note 6)	1,638,210	1,266,053
Costs recoverable from MFDA Investor Protection Corporation (Note 7)	48,940	573,093
Employee benefit plan asset (Note 8)	175,500	–
	<u>\$ 12,612,604</u>	<u>\$ 6,956,624</u>
<b>LIABILITIES AND FUND DEFICIT</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 1,046,261	\$ 699,050
Unearned membership fees (Note 4)	4,639,192	4,512,284
Membership application deposits	17,000	36,750
Due to MFDA Investor Protection Corporation (Note 5)	1,298,865	–
Obligation under capital lease (Note 10)	44,244	19,252
	<u>7,045,562</u>	<u>5,267,336</u>
Accrued employee benefit plans liability (Note 8)	304,500	259,300
Obligation under capital lease (Note 10)	162,332	88,631
	<u>7,512,394</u>	<u>5,615,267</u>
<b>FUND BALANCES</b>		
Operating Fund		
Invested in capital assets	1,431,635	1,158,171
Unrestricted net assets	3,497,869	183,186
	<u>4,929,504</u>	<u>1,341,357</u>
Discretionary Fund (Note 2)	170,706	–
	<u>5,100,210</u>	<u>1,341,357</u>
	<u>\$ 12,612,604</u>	<u>\$ 6,956,624</u>

Approved on behalf of the Board



Robert J. Wright, C.M., Q.C.  
Director



Larry M. Waite  
Director

## STATEMENTS OF REVENUES AND EXPENSES

For the year ended June 30

	2005	2004
<b>OPERATING FUND</b>		
<b>REVENUE</b>		
Membership fees	\$ 18,143,931	\$ 14,724,539
Late filing fees	30,475	48,450
Interest	86,929	18,732
Enforcement cost recoveries	85,329	-
<b>Total Revenue</b>	<b>18,346,664</b>	<b>14,791,721</b>
<b>EXPENSES</b>		
Salaries and benefits	9,984,988	7,208,269
Rent and hydro	1,358,019	920,167
Amortization of capital assets	876,765	588,446
Travel	435,447	389,246
Computer software and maintenance	428,335	259,750
Office and general	342,641	247,506
Board of Directors—fees	248,292	168,125
Board of Directors—expenses	77,720	84,171
Legal	233,242	377,110
Consultants	224,876	190,381
Education	132,917	52,064
Insurance	124,413	108,630
Meetings, seminars and communication	105,516	80,186
Telecommunications	60,286	43,395
Hearing Panels	61,436	-
Bank charges and interest	27,090	35,688
Regional councils	23,766	28,842
Loss on disposal of capital assets	12,768	-
<b>Total Expenses</b>	<b>14,758,517</b>	<b>10,781,976</b>
<b>Excess of Revenue Over Expenses</b>	<b>\$ 3,588,147</b>	<b>\$ 4,009,745</b>

### DISCRETIONARY FUND (Note 2)

<b>REVENUE</b>		
Fines	\$ 2,650,000	\$ -
Interest	20,706	-
<b>Total Revenue</b>	<b>2,670,706</b>	<b>-</b>
<b>EXPENSES</b>		
Contribution to the MFDA Investor Protection Corporation	2,500,000	-
<b>Total Expenses</b>	<b>2,500,000</b>	<b>-</b>
<b>Excess of Revenue Over Expenses</b>	<b>\$ 170,706</b>	<b>\$ -</b>

## STATEMENTS OF CHANGES IN FUND BALANCES (DEFICIT)

For the year ended June 30

	2005			2004	
	Operating Fund		Discretionary Fund	Total	Total
	Invested in Capital Assets	Unrestricted Net assets			
Balance, beginning of year	\$ 1,158,171	\$ 183,186	\$ -	\$ 1,341,357	\$ (2,668,388)
Excess of revenue over expenses	-	3,588,147	170,706	3,758,853	4,009,745
Purchase of capital assets	1,119,267	(1,119,267)	-	-	-
Loss on disposal of capital assets	(12,768)	12,768	-	-	-
Repayment of capital lease obligation	43,730	(43,730)	-	-	-
Amortization of capital assets	(876,765)	876,765	-	-	-
<b>Balance, end of year</b>	<b>\$ 1,431,635</b>	<b>\$ 3,497,869</b>	<b>\$ 170,706</b>	<b>\$ 5,100,210</b>	<b>\$ 1,341,357</b>

### FUND BALANCES (DEFICIT)

## STATEMENTS OF CASH FLOWS

For the year ended June 30

	2005	2004
<b>CASH PROVIDED BY (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Excess of revenue over expenses - Operating Fund	\$ 3,588,147	\$ 4,009,745
Excess of revenue over expenses - Discretionary Fund	170,706	-
Item not involving cash		
Amortization of capital assets	876,765	588,446
Loss on disposal of capital assets	12,768	-
	<u>4,648,386</u>	<u>4,598,191</u>
Changes in non-cash working capital		
Membership fees billed in advance	(77,721)	(1,341,688)
Other membership receivables	18,149	(32,849)
MFDA Investor Protection Corporation assessments billed in advance	(1,298,865)	-
Prepaid expenses	(64,461)	(49,820)
Accounts payable and accrued liabilities	347,211	(155,299)
Membership application deposits	(19,750)	(70,953)
Unearned membership fees	126,908	873,923
Due to MFDA Investor Protection Corporation	1,298,865	-
	<u>4,978,722</u>	<u>3,821,505</u>
Employee benefit plan asset	(175,500)	-
Accrued employee benefit plans liability	45,200	(152,900)
	<u>4,848,422</u>	<u>3,668,605</u>
<b>INVESTING AND FINANCING ACTIVITIES</b>		
Purchase of capital assets	(1,119,267)	(525,469)
Principal payments on capital lease	(43,730)	(14,490)
Costs recovered from Investor Protection Corporation	524,153	(32,334)
	<u>(638,844)</u>	<u>(572,293)</u>
<b>INCREASE IN CASH</b>	<b>4,209,578</b>	<b>3,096,312</b>
<b>CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR</b>	<b>359,927</b>	<b>(2,736,385)</b>
<b>CASH, END OF YEAR (NOTE 3)</b>	<b>\$ 4,569,505</b>	<b>\$ 359,927</b>

# NOTES TO THE FINANCIAL STATEMENTS

## 1 NATURE OF THE ORGANIZATION

The Mutual Fund Dealers Association of Canada (MFDA) is the national self-regulatory organization for the distribution side of the Canadian mutual fund industry. The MFDA does not provide trade association activities for its members. Its Members are firms that have been registered by provincial securities commissions to carry on business as mutual fund dealers. The MFDA regulates the activities of its Members and the approximately 70,000 Approved Persons sponsored by them. The MFDA's regulatory activities include developing rules and policies to govern the business conduct and operations of its Members and their Approved Persons, monitoring compliance with these requirements and applicable securities laws, and enforcing them through disciplinary proceedings conducted before impartial and independent MFDA hearing panels.

The MFDA was incorporated as a not-for-profit corporation on June 19, 1998 under Part II of the Canada Corporations Act and has been formally recognized as a self-regulatory organization by a number of provincial securities commissions in Canada.

As of June 30, 2005, the MFDA had 182 members (191 members as of June 30, 2004).

## 2 SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### Fund Accounting

The MFDA uses the deferral method of accounting for not-for-profit organizations in the preparation of its financial statements consisting of two funds, namely the Operating Fund and the Discretionary Fund.

The Operating Fund accounts for the regular business and activities of the MFDA and consists of the investment in capital assets and unrestricted net assets.

The Discretionary Fund is an internally restricted fund established by the MFDA Board of Directors. The Discretionary Fund receives monies from the collection of enforcement fines and the disgorgement of profits imposed by order of a MFDA hearing panel. Disbursements from the Discretionary Fund are restricted to payments to the investor protection fund and payments for special projects that are in the public interest and beneficial to the public and/or Canadian capital markets, as determined by the MFDA Board of Directors.

### Membership application deposits

A non-refundable deposit is required on all membership applications. The deposit is applied to membership fees when the applicant is accepted for membership.

### Membership fees

Membership fees are calculated annually on a defined formula based on each members' assets under administration, invoiced to members on a quarterly basis and recorded as revenue on a monthly prorated basis.

Membership fees billed in advance are reflected on the balance sheet as unearned membership fees.



Finance and Administration staff of MFDA Toronto office

### Late filing fees

In December, 2003, the MFDA initiated a policy of levying late filing fees to members that do not submit the financial statements required by MFDA rules within the specified due dates. The late filing fees are billed and recorded as revenue on a monthly basis.

### Capital Assets

Capital assets are recorded at cost and are amortized on the following basis:

Computers and software development	Straight-line method over 3 years
Office furniture and equipment	Straight-line method over 10 years
Leasehold improvements	Straight-line method over the term of the lease
Equipment under capital lease	Straight-line method over the term of the lease

### Employee benefit plans

The MFDA accrues its obligations under employee benefit plans and the related costs, net of plan assets. The MFDA has adopted the following policies:

- The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.
- The discount rate used to determine the accrued benefit obligation is determined by reference to market interest rates at the measurement date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments.
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.
- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees is 28 years (2004 – 28 years) for the registered pension plan, 11 years (2004 – 12 years) for the supplementary executive retirement plan and 19 years (2004 – 19 years) for other post-retirement benefits.

### Provision for income taxes

MFDA is a not-for-profit organization within the meaning of the Income Tax Act (Canada). Accordingly, there is no provision for income taxes in these financial statements.

## 3 CASH

Cash includes an amount of \$168,238 (2004 – \$Nil), which is restricted in use for the Discretionary Fund.

## 4 MEMBERSHIP FEES BILLED IN ADVANCE

The membership fees billed in advance represent billings issued in June for the quarterly membership fees due July 15 and are reflected on the balance sheet as unearned membership fees.

## 5 MFDA INVESTOR PROTECTION CORPORATION ASSESSMENTS BILLED IN ADVANCE

On May 3, 2005 the Alberta, British Columbia, Nova Scotia and Ontario Securities Commissions and the Saskatchewan Financial Services Commission (the “Commissions”) provided notice of the approval of the MFDA Investor Protection Corporation (“IPC”) as a compensation fund for customers of mutual fund dealers that are members of the MFDA. The IPC commenced coverage of customer accounts on July 1, 2005. Member assessments are calculated annually on a defined formula based on each members’ assets under administration, and are invoiced to members on a quarterly basis. The MFDA invoices the members on behalf of the IPC and is liable to the IPC for the total of these member assessments.

The IPC assessments billed in advance represent billings issued in June 2005 for the quarterly assessments due September 30, 2005.

## 6 CAPITAL ASSETS

	2005		
	Cost	Accumulated Amortization	Net Book Value
Computers and software development	\$ 1,675,409	\$ 1,279,772	\$ 395,637
Office furniture and equipment	809,957	238,493	571,464
Leasehold improvements	1,045,161	580,972	464,189
Equipment under capital lease	270,275	63,355	206,920
	<u>\$ 3,800,802</u>	<u>\$ 2,162,592</u>	<u>\$ 1,638,210</u>

	2004		
	Cost	Accumulated Amortization	Net Book Value
Computers and software development	\$ 1,291,625	\$ 895,051	\$ 396,574
Office furniture and equipment	586,448	157,497	428,951
Leasehold improvements	604,406	275,579	328,827
Equipment under capital lease	127,852	16,151	111,701
	<u>\$ 2,610,331</u>	<u>\$ 1,344,278</u>	<u>\$ 1,266,053</u>

## 7 COSTS RECOVERABLE FROM MFDA INVESTOR PROTECTION CORPORATION

Certain start-up costs pertaining to the IPC amounting to \$936,612 (\$573,093, as at June 30, 2004) have been incurred by the MFDA. The MFDA recovered \$887,672 from the IPC in June, 2005.

## 8 EMPLOYEE BENEFIT PLANS

MFDA has two defined benefit pension plans for eligible employees, being a registered plan (“RPP”) and a supplementary executive retirement plan (“SERP”). The purpose of the SERP is to supplement the registered plan for designated executive employees. As well, the MFDA has post-retirement benefits (“PRB”) that include health care and dental coverage for retired employees.

The funded status of the MFDA’s benefit plans reconciled to the amounts recorded in the financial statements at June 30 is as follows:

	RPP	SERP	2005 PRB	Total	2004 Total
Fair value of assets	\$1,213,300	\$ 848,600	\$ –	\$2,061,900	\$ 983,800
Accrued benefit obligation	1,620,500	1,070,700	382,300	3,073,500	1,738,100
Funded status (deficit)	(407,200)	(222,100)	(382,300)	(1,011,600)	(754,300)
Unamortized transitional (assets)/ obligation	(5,700)	21,200	12,800	28,300	31,100
Unamortized net actuarial loss	321,300	376,400	156,600	854,300	463,900
Accrued benefit plan asset (liability)	\$ (91,600)*	\$ 175,500	\$ (212,900)*	\$ (129,000)	\$ (259,300)

\* The total of \$304,500 represents accrued employee benefit plans liability as of June 30, 2005.

As of June 30, 2005 the RPP plan assets are invested in a balanced pool fund and the SERP assets, held by the trustee, are invested in a balanced portfolio. At June 30, 2005, \$408,518 (June 30, 2004, \$204,000) is being held in a non-interest bearing retirement compensation arrangement refundable tax account at the Canada Revenue Agency, as required by law. Pension benefits transferred out in 2005 totalled \$2,675 for the RPP (2004 – \$27,334).

The most recent actuarial valuation was completed as of April 1, 2004, where the next required valuation will be as of April 1, 2007. The measurement date for the three plans is June 30.

The MFDA’s net benefit expense and contributions are as follows:

	RPP	SERP	2005 PRB	Total	2004 Total
Net benefit expense	\$ 508,700	\$ 173,000	\$ 97,000	\$ 778,700	\$ 483,400
Contributions					
Employer	501,000	408,000	–	909,000	636,300
Employee	91,600	–	–	91,600	54,800

The significant actuarial assumptions adopted in measuring the MFDA's accrued pension obligations are as follows:

	2005	2004
Weighted average discount rate for pensions	6.00%	6.50%
Weighted average discount rate for post retirement benefits	5.50%	6.50%
Weighted expected rate of return on plan assets	7.00%	7.00%
Weighted average rate of compensation increase	4.5 to 5%	5.00%

The post-retirement benefits reflect a 10% to 15% annual rate of increase in the cost of medical benefits for 2006. These rates are assumed to decrease gradually to 5 percent for 2016 and remain at that level thereafter. The dental benefits are assumed to increase at an annual rate of 3.5%.

## 9 CREDIT FACILITIES

The MFDA has a demand credit facility limited to a maximum of \$3,000,000. The credit facility bears an interest rate of prime plus 0.5% per annum. The MFDA has granted a general security interest to the bank in connection with this facility. As of June 30, 2005 the credit facility was not utilized.

The bank granted the release of the guarantees provided by the Alberta, British Columbia and Ontario Securities Commissions on the previous credit line of \$12,000,000 in July, 2004.

## 10 COMMITMENTS

### (a) Lease obligations

The MFDA has entered into operating leases for its office premises and three capital leases for office equipment. The capital leases have implicit interest rates of 7.1%, 4.9% and 5.4%, and expire in March 2009, March 2010 and February, 2010, respectively. The aggregate future minimum lease payments associated with these three leases is \$233,213, which includes interest charges of \$26,637.

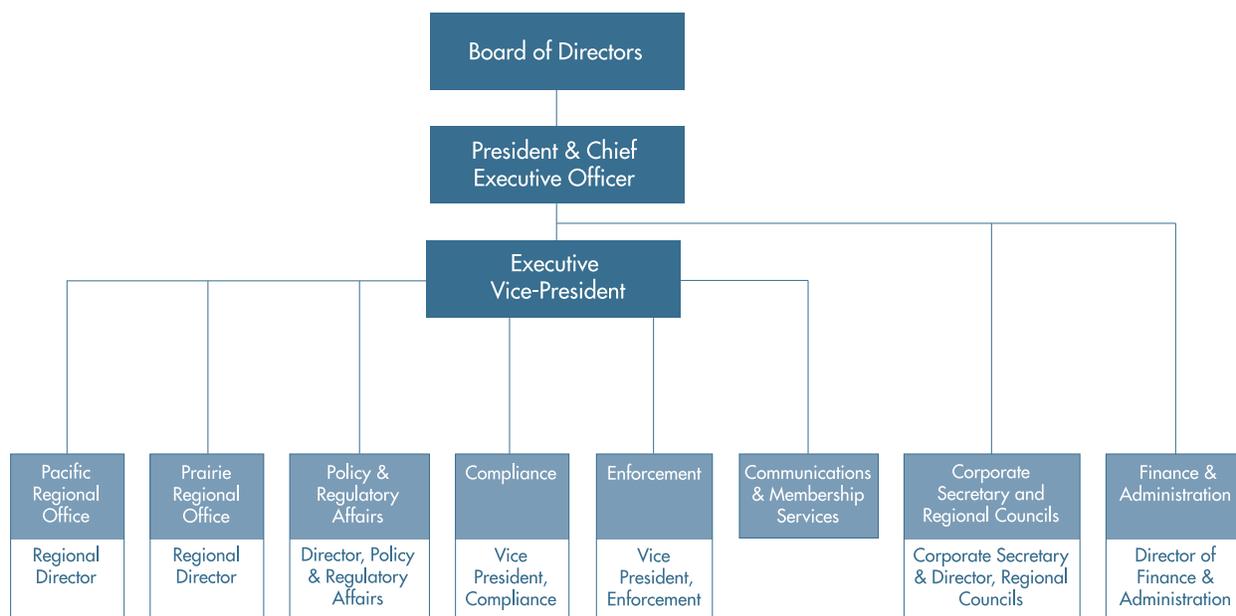
Operating and capital lease obligations, excluding operating costs for future years and sales tax, are as follows:

2006	\$ 561,839
2007	222,917
2008	69,896
2009	41,905
2010	18,108
Thereafter	—
	\$ 914,665

### (b) Guarantees

The MFDA provided a guarantee of the \$30 million line of credit granted to the IPC by the bank.

## MFDA ORGANIZATIONAL CHART



### Executive Officers

Robert J. Wright, C.M.,Q.C.  
 W. David Wood  
 Larry M. Waite  
 Mark T. Gordon

Chair  
 Vice-Chair  
 President & Chief Executive Officer  
 Executive Vice-President

### Officers

Shaun Devlin  
 Karen McGuinness  
 Gregory J. Ljubic  
 Dale Pratt  
 Bernadette Devine

Vice-President, Enforcement  
 Vice-President, Compliance  
 Corporate Secretary and Director of Regional Councils  
 Controller  
 Assistant Corporate Secretary

### Management Directors

Wendy Royle  
 John Smeeton  
 Paul Reid  
 Paige Ward

Regional Director, Pacific Regional Office  
 Regional Director, Prairie Regional Office  
 Director of Finance and Administration  
 Director of Policy and Regulatory Affairs

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[www.mfd.ca](http://www.mfd.ca)



[WWW.MFDA.CA](http://WWW.MFDA.CA)