



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



Raising the standard of regulation in Canada  
for the protection of investors through  
commitment to collaboration, staff excellence  
and regulatory best practices.

**ANNUAL REPORT**



# Message from the President and Chief Executive Officer

I am pleased to present the MFDA's 2009 Annual Report. The Report is being presented later than usual because of the delay in holding the 2009 Annual Meeting of Members announced on November 11, 2009. However, the AGM has been called for March 4, 2010 and our Report is now being presented to Members.

In May 2009, the MFDA Board of Directors approved the MFDA's Strategic Plan for 2009-2011. The Plan builds upon the accomplishments of two previous plans and articulates the MFDA's vision, core strategic and operational goals, desired outcomes and key initiatives. Key strategic and operational goals in the Plan include enhancing our consultation with the industry; exploring ways to further collaborate with other regulators; continuing to pursue Staff excellence; and ensuring that we continue to adopt regulatory best practices. These goals provide a roadmap for fulfilling the MFDA's strategic direction over the coming years.

The Task Force on Governance Issues, which was established in February 2009 to review a number of issues that arose at the 2008 Annual General and Special Meeting of Members, issued its Final Report in August 2009. We believe that the Final Report addresses concerns raised by some Members about the degree to which they participate in the affairs of the MFDA as a self-regulatory organization, while at the same time preserving the elements of the MFDA's structure that permit it to represent the diversity of its Members and function effectively as an SRO. We believe that the Task Force's recommendations, which incorporate feedback received from Members and other key stakeholders obtained during two comment periods, will enhance the MFDA's corporate governance processes and help ensure that the interests of all Members are represented at the Board level.

The enhancements to the MFDA's governance procedures proposed by the Task Force were confirmed by a large majority of Members at a Special Meeting held on October 2, 2009. However, the MFDA has not been able to implement these enhancements to date because the necessary regulatory approvals have not been granted. The MFDA has been advised that such approvals cannot

be expected at least until the completion of the proceedings that have been initiated at the request of a Member in respect of certain matters referred to in the section of this Report on "Corporate Governance".

Following the holding of the AGM on March 4, 2010, the Board of the MFDA is expected to have significant turnover from the time of the 2008 AGM with 6 new Public Directors and 1 new Industry Director. I look forward to working with the new directors as the Board navigates the complexity of issues facing investors and Members today.

The Members-only section of the MFDA website launched in 2009 will further promote open communication with our Members and act as a valuable resource to solicit the views of Members and stakeholders on various industry and regulatory issues.

Going forward, the MFDA will continue to meet with Members and industry associations on a regular basis to obtain real-time information about market practices, concerns and problems facing Members. This type of information is vital to our ability to meet our regulatory mandate in the most direct, efficient and effective manner possible.

Finally, I would like to thank MFDA management and staff for their continuing dedication, hard work and ongoing commitment to excellence.



**Larry M. Waite**  
President & CEO

## MFDA Vision

Raising the standard of regulation in Canada for the protection of investors through commitment to collaboration, staff excellence and regulatory best practices.



# Year in Review

## Membership Information

The MFDA is Canada's national self-regulatory organization responsible for regulating the activities and operations of 141 mutual dealer firms (Members) and their approximately 75,000 salespersons (Approved Persons). Members account for approximately \$272 Billion of the approximately \$587 Billion of client assets under administration in the Canadian mutual fund industry. The MFDA presently operates in the Province of Quebec pursuant to a Cooperative Agreement with the Autorité des marchés financiers and the Chambre de la sécurité financière.

## CORPORATE GOVERNANCE

At the December 2008 Annual General and Special Meeting of Members, a number of issues relating to the governance of the MFDA were discussed or resulted from the meeting, including: (i) the failure of By-law No. 15 concerning the definition of 'Public Director' and directors' terms of office to be approved by two-thirds of Members voting at the meeting; (ii) the process for nominating and selecting Board members; (iii) the process for making and/or amending the By-laws, Rules and Policies of the MFDA; and (iv) the failure to elect three proposed Public Directors.

Following the meeting, the MFDA and its Board of Directors embarked on a review of its current governance structure and in early February 2009 a Task Force on Governance Issues was formed to review the issues outlined above. The Task Force was comprised of the MFDA Governance Committee and two independent individuals with industry experience, one in the role of 'public member' and one in the role of 'industry member'. The Task Force met eight times between March 27, 2009 and August 11, 2009. The Final Report of the Task Force was approved by the Board of Directors on August 18, 2009. The Task Force made three key recommendations in its Report:

- Amendments to the definition of Public Director and directors' terms of office set out in By-law No. 15 should be re-tabled for Member approval at a Special Meeting of Members;
- The Board of Directors should be increased from 13 members to 15; and
- A revised director nomination process should be introduced under which two Industry Directors will at all times be selected by the Members at large.

A Special Meeting of Members was held on October 2, 2009 at which Members voting in person and by proxy approved the amendments to By-law No. 1 set out in By-law No. 15 by the requisite two-thirds of votes cast at the meeting.

On October 9, 2009 a Member, Partners in Planning Financial Services Ltd., filed with the British Columbia Securities Commission a Notice of Request for Review of Decision in respect of the MFDA's revisions to its By-law No. 1 following the confirmation of By-law No. 15. As a result of the filing of the Request for Review and the time required to have the matter heard, as well as the British Columbia Securities Commission's decision to review the issues, the MFDA was not in a position to determine whether By-law No. 15 would be effective for the 2009 Annual General Meeting scheduled for December 3, 2009. Accordingly, on November 11, 2009, the MFDA advised its Members of the decision of the Board of Directors to defer calling its 2009 AGM until a later date.

On January 4, 2010, the MFDA was advised by the British Columbia Securities Commission that approval of By-law No. 15 could not be expected until at least the completion of the proceedings initiated by the Notice of Request referred to above. The MFDA will continue to monitor the circumstances relating to the Request for Review and By-law No. 15. In the meantime, the Board of Directors has called an AGM to be held on March 4, 2010.

## Director Compensation

Public Directors receive an annual retainer of \$15,000. Each Public Director who serves as the Chair of a Committee of the Board receives an additional annual retainer of \$2,500, except for the Chair of the Audit & Finance Committee who receives \$4,000. Public Directors receive \$1,500 for their attendance at Board meetings and up to \$1,500 for Committee meetings. In the event that an out-of-town Public Director attends a Board or Committee meeting in person, an additional \$1,000 supplementary fee is paid.

In circumstances where a Public Director serves as the Chair of the Board, the Board of Directors has the discretion to set the amount of the Chair's annual retainer, which is reviewed annually during the tenure of the individual. Presently, the retainer for the Chair of the Board is \$70,000 per year.

Industry Directors are not compensated for their participation on the Board or its Committees. All Directors are reimbursed for travel and out-of-pocket expenses in connection with Board and Committee meetings.

## Meetings

There were a total of 37 corporate meetings held during the fiscal year ending June 30, 2009, including 11 Board meetings; 5 Audit & Finance Committee meetings; 1 Executive Committee meeting; 8 Governance Committee meetings; 4 Regulatory Issues Committee meetings; 7 Task Force on Governance Issues meetings; and 1 Annual General and Special Meeting.



## REGIONAL COUNCILS AND HEARING PANELS

The MFDA has four Regional Councils corresponding to the following geographic Regions: the Atlantic Regional Council representing Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland and Labrador; the Central Regional Council representing Ontario and Quebec; the Prairie Regional Council representing Alberta, Saskatchewan, Manitoba, Northwest

Territories and Nunavut; and the Pacific Regional Council representing British Columbia and Yukon Territory.

All Regional Council hearings-related matters are administered and coordinated by the Office of the Corporate Secretary which is separate from and independent of the MFDA's Enforcement Department.

# Regulatory Operations

## Compliance

### Sales Compliance Examinations

The second cycle of sales compliance examinations was completed in December 2008. During 2008, staff performed 59 head office examinations and 43 branch examinations. A total of 159 head office examinations and 167 branch examinations were performed in the second cycle of examinations.

As of June 30, 2009, of the 159 examinations, 120 had been closed and 39 were awaiting satisfactory response or had been referred to Enforcement.

For the second cycle of sales compliance examinations, MFDA Compliance established benchmarks to issue 70% of examination reports within 15 weeks of the completion of field work and all reports within 22 weeks of completion of field work. Of the 159 reports issued, 92% were issued within 15 weeks and all reports were issued within 22 weeks of completion of field work.

### Financial Compliance Examinations

During calendar 2008, the Financial Compliance group satisfied its benchmark to perform an annual on-site financial examination of all active Level 4 Members. Furthermore, all examination reports were issued within the established benchmark timeframe, that is, 70% of reports were issued within 15 weeks of completion of field work and all remaining reports within 22 weeks of completion of field work. Of the 39 examinations conducted in 2008, 26 were in Ontario, 3 in Manitoba, 3 in British Columbia, 2 in Alberta and 5 in Quebec. Reports for 31 examinations have been issued and, of those, 19 examination files were closed by the end of 2008.

### Financial Compliance Desk Reviews

During fiscal 2009, approximately 1,825 unaudited monthly and 155 audited annual financial reports were reviewed by Financial Compliance staff. In a number of instances capital and/or reporting issues were identified through this review process. Financial

Compliance staff took steps to communicate with Member staff on a timely basis so that corrective action could be taken.

In September 2008, MFDA staff offered an information session for external auditors of MFDA Member firms. The objective of this session was to enhance auditors' understanding of MFDA financial requirements and the specific requirements relating to audit engagements of Member firms. In addition, the session provided an overview of updates on relevant initiatives at the time.

### Going Forward – Projects and Initiatives

#### Compliance Examination Cycle

The third cycle of sales compliance examinations commenced in January 2009. Members are prioritized for examination based on several factors, including their risk model score, the length of time since their last examination and information obtained from the 2008 Member survey.

Enhancements to the examination process for the third cycle of examinations include applying the risk model score in the determination of sample sizes and in the determination of how many branch locations are to be visited.

The benchmarks for issuing all examination reports, including financial examinations, have been changed. 80% of the examination reports should be issued within 15 weeks of completion of field work and all reports should be issued within 20 weeks of completion of field work.

#### Consideration of Impact of Adopting International Financial Reporting Standards

The Canadian Accounting Standards Board has confirmed that International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian Generally Accepted Accounting Principles for publicly accountable enterprises ("PAE") effective for fiscal years beginning on or after January 1, 2011. This pronouncement is significant to the MFDA and its membership in that, while some MFDA Member firms



meet the PAE definition and will be required to report using IFRS, other Members do not meet the definition and, thus, would not be required to amend their financial reporting to comply with IFRS. MFDA staff will be reviewing the changes in accounting standards and assessing the impact these changes will have on the membership and our regulatory oversight role.

## Enforcement

### Investor Concerns

MFDA staff have worked on an ongoing basis since 2005 with staff of the Ontario Securities Commission (“OSC”), the Investment Industry Regulatory Organization of Canada (“IIROC”) and the Ombudsman for Banking Services and Investments (“OBSI”) on a number of issues relating to the concerns of investors, including:

- Improving the complaint-handling process for retail investors;
- Enhancing communications with retail investors;
- Making access to information easier for investors; and
- Providing clarity on existing redress mechanisms.

In 2008, the Joint Standing Committee on Retail Investor Issues (“JSC”) completed a project relating to product suitability in which the JSC obtained written responses from the public in relation to three broad suitability questions and then followed up to conduct further dialogue with persons who responded to the initial questions. On December 17, 2008, the JSC published a report titled “Public Consultation on Product Suitability” summarizing the comments received. The information gathered from the project is available for consideration in relation to policy issues reviewed by the JSC and each of the four organizations (OSC, IIROC, OBSI and MFDA). In 2009, the JSC will be conducting a quantitative survey to explore general issues regarding information that investors are seeking.

### Enforcement Priorities

The MFDA reviews supervision by the Member and its supervisory personnel in all cases. This is an important part of our enforcement and compliance strategy that focuses on addressing Members’ efforts in proactively avoiding non-compliant situations by implementing effective supervisory regimes.

The following case types will continue to receive high priority given the level of potential client harm:

- Suitability of investment and leveraging recommendations;
- Securities and other financial business outside the Member;
- Theft and fraud, including fraudulent outside business activity;
- Personal financial dealings, including borrowing from clients;

- Abusive sales practices, including excessive trading (churning), blank signed trading forms/discretionary trading and misleading sales communications;
- Sale of exempt products;
- Member financial requirements; and
- Failure to cooperate with the MFDA.

### Expedited Hearings

In September 2006, the MFDA Board of Directors approved amendments to section 24 of MFDA By-law No. 1 dealing with the process for expedited hearings in certain situations. The amendments were approved effective August 1, 2008. The MFDA subsequently conducted two proceedings under the new provisions in 2008. The MFDA also developed a new section of its Rules of Procedure to deal with expedited hearings, and, in March 2009, sent those new Rules, together with minor revisions to its existing Rules, to the CSA for approval.

### Disciplinary Action

The Department commenced 34 proceedings during the year, which included 9 cases regarding Member supervision. In addition, 132 cases were concluded by warning letter or other informal discipline.

17 cases concluded during the year, 10 of which involved allegations against current or former Approved Persons resulting in 4 permanent prohibitions and total fines in the amount of \$2,387,966. Nine of these cases involved allegations against Members and resulted in fines of \$3,216,114. Of the \$5,604,080 in fines imposed during the year, the MFDA collected \$480,000.

### Business Process Management

Effective February 15, 2009, all Enforcement Department case activity is managed through the Business Process Management (“BPM”) system that was implemented earlier in the MFDA Compliance Department. BPM allows for better tracking and management reporting of case activity and incorporates robust workflow controls.

### Going Forward – Projects and Initiatives

#### Member and Industry Risks and Trends

The Enforcement Risk Model has now been revised to include data from reported Member Event Tracking System events. This will assist the MFDA in assessing Member risk and communicating this to Members through our new Member risk scorecards.

## Supervision

The MFDA Enforcement Department reviews supervision in every case. During the last quarter of 2008 and the first quarter of 2009, we concluded seven significant Member and Branch Manager supervision cases, which will assist the MFDA and Members from an educational and general deterrence perspective. The MFDA will build upon this activity and it is expected that these efforts will result in additional action against Members, officers and supervisory personnel in 2010.

## Proactive Enforcement Action

We intend to increase the focus of our enforcement activities by proactively taking action in situations involving ongoing public harm and other high risk activities and situations. We will take formal action under section 24.3 of By-law No. 1 and informal disciplinary action on an interim basis, as appropriate, to address situations that might otherwise not be resolved until the completion of a full investigation and disciplinary hearing. Situations will include those involving Members' completion of reasonable supervisory investigations in response to red flags regarding possible widespread Approved Person misconduct, significant deficiencies in Member general supervisory procedures and situations where Approved Persons transfer to a new dealer during an ongoing investigation.

## Policy

### By-law Amendments

#### **MFDA By-Law No. 1 – Section 35 (No Actions Against the Corporation)**

Proposed amendments to section 35 of By-law No. 1 were published for a 90-day comment period on June 26, 2009. The proposed amendments are intended to: (i) ensure that the MFDA IPC and its directors, officers and personnel are adequately protected in the discharge of their investor protection mandate from legal actions by MFDA Members, Approved Persons or other persons under the jurisdiction of the MFDA; and (ii) provide for, within the MFDA By-laws, the terms of the relationship between the MFDA and MFDA IPC and existing MFDA and Member obligations to the MFDA IPC.

### Rule Amendments

#### **MFDA Rule 2.2 (Client Accounts), Policy No. 2 Minimum Standards for Account Supervision, Rule 2.8 (Client Communications) and 5.3 (Client Reporting)**

Proposed amendments to Rule 2.2, Policy No. 2 and Rules 2.8 and 5.3 were republished for a second 90-day comment period on April 24, 2009. The proposed amendments were drafted to address the issues of clarity of the Member/client relationship and performance reporting under the Client Relationship Model project, as well as various other regulatory issues identified by MFDA Compliance and Enforcement staff. The MFDA has revised the proposed amendments to reflect comments received during the first comment period and to harmonize, to the extent possible, the proposed requirements with those proposed by IIROC.

#### **MFDA Rule 2.4.1 (Payment of Commission to Unregistered Corporation)**

Proposed amendments to Rule 2.4.1 were published for a 90-day comment period on June 19, 2009. The proposed amendments are intended to codify the existing practice with respect to the payment of commissions to unregistered corporations and to allow Members and their Approved Persons an appropriate degree of flexibility in how they structure their business affairs, provided that certain conditions are satisfied.

## Policy Amendments

#### **MFDA Policy No. 3 Complaint Handling, Supervisory Investigations and Internal Discipline**

Proposed amendments to MFDA Policy No. 3 were republished on March 13, 2009 for a second comment period as a result of additional changes made in response to comments received during the first comment period. The proposed amendments are intended to provide additional guidance with respect to the standards that Members should have in place regarding complaint handling and supervisory investigations and harmonize the complaint handling requirements of the MFDA with those of IIROC and requirements to be adopted under National Instrument 31-103.

### Going Forward – Projects and Initiatives

#### **CSA Registration Reform Project**

In 2008 and 2009, MFDA staff continued to participate in the CSA Registration Reform Project that is intended to harmonize and modernize the registration requirements among the CSA jurisdictions.

#### **Principal Protected Notes**

In 2008, the MFDA received a request by the CSA to take appropriate action to ensure that KYC and suitability obligations apply to all dealings in Principal Protected Notes (“PPNs”) by



Approved Persons of MFDA Members. The CSA confirmed their expectation that the MFDA enforce KYC and suitability obligations on the sale of any PPN, whether or not it falls within the definition of a “security” in all jurisdictions, including PPNs that are deposit instruments currently sold by Approved Persons outside an MFDA Member.

In response, MFDA staff solicited Member comments on the impact and implications of possible Rule amendments and developed a discussion paper for consideration by the Policy Advisory Committee. The MFDA is currently discussing the issue with the CSA and IIROC.

### **MFDA Rule 3.3.2 (Cash)**

Pursuant to MFDA Rules and National Instrument 81-102, MFDA Members are required to hold client cash in trust and segregate client cash for investment in mutual funds from client cash for other investments and are prohibited from earning interest on client funds held in trust. Given that amendments that would exempt MFDA Members from the relevant provisions of NI 81-102 are being considered by the CSA, and in response to Member comments and exemptive relief requests, MFDA staff will be developing amendments to Rule 3.3.2 to remove the requirements related to the prohibition on commingling and the allocation and distribution of interest earned on client cash held in trust.

### **Industry Participation**

As part of our goal to improve industry participation, going forward the MFDA will request an extension of the comment period for certain material Rule proposals from 30 days to a minimum of 60 or 90 days. This will assist us in ensuring that stakeholders have a reasonable period of time to understand, consider and ultimately comment on Rule proposals. The MFDA policy development process will be further enhanced by increasing

Member awareness and understanding of the role and activities of the Policy Advisory Committee by providing access to meeting materials on the Members-only section of the MFDA website. This will assist in ensuring that Members are aware of upcoming and current policy initiatives and understand the issues, background and alternatives considered in determining a regulatory response. We have identified and acted upon several enhancements to the policy development process. Going forward, we will seek preliminary comment on material policy initiatives in order to ensure that Member views and comments are considered at an early stage in the policy development process. Comment on material policy proposals will be sought through various means, including discussion papers, surveys and meetings with industry representatives.

## **Membership Services**

The MFDA has developed a Members-only section for its website to provide Members with secure electronic means of accessing and amending their MFDA membership information, including requests to change partners, directors or officers, obtaining MFDA Member-only information online (including results of Member surveys, materials for Annual General Meetings or reminders of MFDA By-law and Rule amendments open to public comment), and retrieving Member risk-rating information generated by the MFDA’s internal risk model.

During the period July 1, 2008 to June 30, 2009, the Membership Services Department responded to approximately 510 inquiries by telephone and email. The majority of inquiries come from MFDA Members and Approved Persons on such topics as the registration of Approved Persons, the Electronic Filing System and questions about the latest Notices and Bulletins.

## **Financials**

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The financial statements for the fiscal year ended June 30, 2009 with 2008 comparatives and accompanying notes and Management Discussion and Analysis are available on the website at [www.mfda.ca](http://www.mfda.ca).

## How to Contact Us

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For more information on the MFDA, please visit our website: [www.mfd.ca](http://www.mfd.ca)