



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

Submissions to the Standing Senate Committee

on

Banking, Trade and Commerce

Regarding

Consumer Issues Arising in the Financial Services Sector

Submitted By:

Larry M. Waite
President and Chief Executive Officer
Mutual Fund Dealers Association of Canada

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Introduction

The Mutual Fund Dealers Association of Canada ("MFDA") is the national self-regulatory organization for the Canadian mutual fund dealer industry.

It was established in mid-1998 at the initiative of the Canadian Securities Administrators in response to the explosive growth of mutual funds in Canada in the late 1980's and a recognition among securities regulatory authorities that the mutual fund industry and investors would benefit from more robust regulation and effective oversight.

The MFDA is structured as a not-for-profit corporation and is responsible for regulating the activities of mutual fund dealers in terms of their capital adequacy and conduct of business. The MFDA has three operating offices: a head office in Toronto, Ontario, and a Regional Office in each of Calgary, Alberta and Vancouver, British Columbia. The majority of the MFDA's 100 staff are actively involved in compliance and enforcement activities, both of which have a strong investor protection orientation.

The MFDA is a pure regulator with a single purpose mandate reflected in its corporate vision: *To enhance investor protection and strengthen public confidence in the Canadian mutual fund industry.* The MFDA performs no industry representation or trade association functions for Members or Approved Persons.

MFDA Membership Information

The following is a summary of MFDA membership information, as at April 7, 2005.

- Number of Members: 181 Member Firms
- Distribution of Members by Head Office Location:
 - Ontario: 122 Members
 - British Columbia: 16 Members
 - Quebec: 14 Members
 - Alberta: 8 Members
 - Manitoba: 8 Members
 - Saskatchewan: 6 Members
 - Nova Scotia: 4 Members
 - New Brunswick: 3 Members
- Number of Approved Persons Sponsored by Members: Approximately 70,000
- Aggregate Assets under Administration(excluding Quebec) for all Members: Approximately \$244.4 Billion

Corporate Governance and Public Participation

There are two principal governance structures at the MFDA: the Board of Directors and Regional Councils. There is strong public representation on each of these structures.

A. Board of Directors

In December 2003, the MFDA completed a reform of its governance structure.

The size of the Board of Directors was reduced and public participation was increased. The 13-member MFDA Board is comprised as follows:

- 6 Public Directors,
- 6 Industry Directors (5 of whom must be officers or employees of a Member), and
- MFDA President and Chief Executive Officer.

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

The Chair of the Board of Directors is presently a Public Director. In addition, all five Board Committees (Audit; Governance; Regulatory Issues; IPC; and Executive) are presently chaired by a Public Director.

B. MFDA Regional Councils

MFDA Regional Councils are a governance structure separate and distinct from the Board of Directors. There is a Regional Council in each of four geographic regions (Atlantic, Ontario, Prairie and Pacific) and each is comprised of:

- Elected representatives of Members in the applicable Region,
- *Ex officio* representatives, and
- Appointed representatives, comprising Public representatives with legal training and Industry representatives with securities industry experience.

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

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

MFDA disciplinary proceedings against a Member or Approved Person in a Region are conducted before an independent, impartial Hearing Panel comprised of 3 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 practising lawyer in Canada. This ensures that all MFDA disciplinary proceedings are conducted in accordance with the highest standards of procedural fairness. Neither members of the MFDA Board of Directors, nor MFDA staff, participate in the decision-making activities of Regional Council Hearing Panels.

MFDA Hearings are transparent and are conducted in public. Information respecting the Hearings is reported to the CSA, disseminated by news release and posted to the MFDA web site, for the benefit of public. Arrangements are in place to ensure that Hearings information is also published in the Ontario Securities Commission Bulletin.

MFDA Regulatory Operations and Investor Protection

The principal MFDA regulatory operations are:

- Policy
- Compliance
- Enforcement
- Communications

A. Policy

Policy staff are active in monitoring the effectiveness of MFDA By-laws, Rules and Policies; recommending changes, where appropriate; drafting new or amended MFDA regulatory instruments; and drafting Notices and Bulletins for Members to assist with the interpretation of MFDA requirements.

One of the first substantive regulatory activities performed by the MFDA following its establishment in 1998 was the development of appropriate rules and policies to govern the business conduct and operations of mutual fund dealers in Canada. Five working committees were established by the MFDA, comprising representatives from industry, regulators and the public, and a comprehensive Rulebook was developed and approved by the CSA. The Rulebook was drafted with a strong bias in favour of investor protection and included many requirements which were new for the industry.

B. Compliance

The Compliance Department is responsible for monitoring Member firms' adherence with MFDA requirements. It is organized into 2 main groups:

- **Sales Compliance**

This group is principally involved in conducting on-site field reviews of Member operations, at both head office and branch locations, preparing reports of findings, reviewing responses provided by Members and managing related follow-up.

- **Financial Compliance**

This group is principally involved in conducting a review of monthly and annual financial questionnaires and reports submitted by Members, including evaluating risk adjusted capital of Members and variances in filings from one time period to another.

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

- **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 MFDA regulatory requirements. Based on reviews conducted to date, it is clear that these interactions have resulted in better practices and procedures at Members, with consequential benefits for clients. It is noteworthy that prior to the establishment of the MFDA, the majority of mutual fund dealers in Canada had never been subject to an on-site compliance review by securities regulators.

Compliance staff is also active in providing one-on-one education with Members in the course of monitoring Member follow-up to address deficiencies identified during compliance reviews and is frequently invited to give presentations at Member offices. Compliance staff have also presented education seminars to auditors of Members to facilitate better understanding of MFDA financial reporting requirements.

Member Solvency

The MFDA requirement that Members file their financial statements on a monthly basis positions Compliance staff to monitor solvency issues affecting Members at an early juncture, thereby affording an opportunity for the MFDA to take appropriate action promptly and resolve issues with Members as they arise. Such action could include a temporary prohibition on the Member receiving new clients or opening new branch locations, each of which have a strong investor protection impact.

Identification of Enforcement Issues

Compliance reviews can identify serious instances of non-compliance or misconduct by a Member or Approved Person, often unbeknownst to senior representatives of the Member, which are then referred to the Enforcement Department for appropriate follow-up. Early identification of serious problems is beneficial in minimizing ongoing or future harm to investors.

Recurring Issues or Practices.

The Compliance Department, through its reviews, can identify recurring or new issues or practices. This information is shared with Policy and Enforcement staff to identify whether modifications to the Rulebook might be appropriate or whether some other regulatory action is required.

Referral of Issues to Other Regulators.

The Compliance Department shares information actively with securities commission staff. Issues outside the jurisdiction of the MFDA, which might have gone unnoticed by securities commissions and other agencies but for MFDA compliance activities, can be identified during compliance reviews and then referred for appropriate follow-up.

There is a strong education theme that has influenced Compliance activities at the MFDA to date. The MFDA is cognizant that the new regulatory requirements introduced by the MFDA Rulebook have necessitated changes in the way in which many Members operate their respective businesses. The objective is to encourage all Members to embrace a culture of compliance, for the benefit of the investing public.

To date, the MFDA has completed full compliance reviews of 140 of its 181 Members. The MFDA expects to have completed full compliance reviews of all remaining Members by the end of 2005.

C. Enforcement

The Enforcement Department's key goal is to enforce compliance with MFDA regulatory requirements with a view to enhancing investor protection. It 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, and
- 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 3 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.
- **Litigation**
This group assesses cases and is responsible for commencing disciplinary proceedings before Hearing Panels of Regional Councils, where appropriate. This group became fully operation in December 2004.

The Case Assessment group receives referrals from investors and others, including:

- Public complaints,
- Complaint referrals from securities commissions and other self-regulatory organizations,
- Uniform Termination Notices filed by Members with securities commissions,
- Mandatory Member reporting of theft, misappropriation or forgery in accordance with MFDA Policy 3,
- Member voluntary reporting,
- Police, media and other sources, and
- MFDA Compliance Department:
 - Filing deficiencies,
 - Egregious conduct, such as theft, fraud, abusive sales practices and discretionary trading, and
 - Refusal or failure to provide documents or respond to MFDA requests

The MFDA maintains a toll-free telephone number which is advertised on the MFDA web site. In addition, the MFDA web site contains information respecting complaint processes and a standard complaints form.

Case Assessment staff contact all investors who have referred a complaint to the MFDA. In some circumstances, the matter may be outside the jurisdiction of the MFDA, in which event efforts are made to assist the investor in identifying alternative avenues of redress. In addition, the MFDA advises all complainants about the Ombudservice for Banking Services and Investments.

The Enforcement Department informs all investors as to the disposition of their complaint.

The Enforcement Department recognizes that timely review of enforcement matters, including complaints, is an important regulatory objective. It ensures that satisfactory information, both documentary and testimonial, can be gathered while information is still readily available. Timely completion of matters generates confidence in processes. The Enforcement Department has established case-handling benchmarks to support its investor protection and market integrity mandate.

The following are selective Enforcement statistics for 2004:

- Case Assessment Group:
 - 683 Intake Matters
 - 298 Opened as Cases
- 63 Cases escalated to Investigations Group
- 9 Cases escalated to Litigation Group
- Disciplinary Action:
 - 1 Settlement Hearing
 - 59 Warning Letters
 - 5 Agreements and Undertakings

The following are selective Enforcement statistics for the first three months of 2005:

- Open Cases at March 31, 2005:
 - 50 Investigations
 - 225 Case Assessment Files
- Informal Discipline:
 - 34 Warning Letters
 - 3 Agreement and Undertakings
- Litigation:
 - 6 Notices of Hearing

Information-Sharing and Joint Efforts with Other Organizations

The MFDA collaborates actively with securities regulatory authorities and other agencies across Canada respecting policy, compliance and enforcement matters. Information-sharing arrangements among regulators are very beneficial for investors because they ensure that matters referred to one organization, which may be outside that organization's jurisdiction, will be referred to an appropriate agency for follow-up. Information-sharing also assists in identifying new or emerging trends or issues that could have an impact on investor protection or the public interest.

Joint regulatory and law enforcement initiatives include:

- **Joint Compliance Examinations with Securities Regulators**
MFDA Compliance staff initiated efforts with securities regulatory authorities to coordinate staff participation in joint examinations or staff secondments. Staff have participated in joint examinations with the securities commission staff in British Columbia, Alberta, Saskatchewan and Manitoba.

- **Joint Law Enforcement Initiatives**

In Ontario, the MFDA is a member of the Joint Advisory Committee of the RCMP Integrated Market Enforcement Team, and a member of the Securities Enforcement Review Committee. Membership of both committees includes the enforcement groups of other self-regulatory organizations, the Ontario Securities Commission, and federal, provincial and municipal police forces. In British Columbia, the MFDA is a participant in monthly Joint Enforcement Meetings chaired by the B.C. Securities Commission and involving other self-regulatory organizations and law enforcement personnel.

Ombudservices

The MFDA is a sponsoring organization of two important consumer dispute mechanisms in Canada:

- The Financial Service OmbudsNetwork ("CFSON"), and
- Ombudsman for Banking Services and Investments ("OBSI").

OBSI is an independent consumer dispute service for clients of banks and Members of the MFDA, IDA and IFIC which reviews client complaints and may make non-binding recommendations that investors be compensated in appropriate circumstances.

MFDA By-laws require that MFDA Members must:

- Participate in the designated ombudservices,
- Provide their new clients, and all clients that submit a written complaint, with information respecting OBSI and CFSON; and
- Co-operate with, and provide information to, OBSI in connection with their investigations.

Members that do not provide information to OBSI or provide false information are subject to MFDA enforcement action.

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

All investors referring matters to the MFDA are informed about the services available through OBSI and are provided with contact information for OBSI.

MFDA Investor Protection Corporation

A top priority for the MFDA in 2004 has been the establishment of an investor protection fund for clients of MFDA Members in the event of an insolvency of a Member.

The MFDA and MFDA Investor Protection Corporation filed an amended application with the CSA in November, 2004 under which:

- Clients of MFDA Members will be afforded the same coverage as the coverage afforded by the Canadian Investor Protection Fund in the securities industry, namely, \$1 million per account, and
- The coverage will extend to all client assets held by the Member, not just mutual funds.

The public comment process conducted by the Ontario Securities Commission expired on March 28, 2005 and MFDA staff are in the process of summarizing public comments for the CSA.

It is expected that the fund will be operational and offering coverage by July 2005 and this represents a significant and new investor protection initiative in Canada.

Conclusion

The MFDA is a regulator of mutual fund dealers and their Approved Persons. Its regulatory activities are strongly oriented to ensure that investor protection and the public interest are central to the MFDA. This is reflective in the MFDA's governance structures, which include meaningful and active participation of public representatives, and its core regulatory operations comprising policy, compliance and enforcement.

Although a relatively young regulator of financial services firms, the MFDA has already made a significant impact on the industry from an investor protection perspective. Members are better aware of, and complying with, their obligations and responsibilities to investors.

Investors too are more aware of mutual fund dealer duties and are increasingly aware of the MFDA's role in enforcing them. If there is a problem, investors know that the MFDA will follow-up through its responsive complaint process and extensive information-sharing arrangements with other regulators, organizations and law enforcement agencies.