

CONSULTATION ON THE HARMONIZATION OF MUTUAL FUND DISTRIBUTION REGULATIONS

October 1, 2010

Table of Content

BACKGROUND	P.3
1. BENEFITS OF HARMONIZED REGULATIONS	P.4
2. IMPLEMENTATION OF A COMPATIBLE REGULATION	P.4
2.1 LEGAL IMPLEMENTATION OF THE NORMATIVE FRAMEWORK	P.5
2.2 OPERATIONAL IMPLEMENTATION	P.6
2.3 TRANSITION	P.7
3. IMPLICATIONS FOR THE CHAMBRE DE LA SÉCURITÉ FINANCIÈRE	P.7
4. REGULATION INCOMPATIBLE WITH QUÉBEC STATUTES AND REGULATIONS	P.7
5. IMPACTS OF THE ADOPTION OF A COMPATIBLE MDFA REGULATION	P.11
APPENDIX	P.18

BACKGROUND

In September 2004, the government ministers responsible for securities in Canada signed an agreement to develop and adopt a securities passport regime, with the goal of enabling issuers, dealers and representatives to access markets throughout Canada by dealing exclusively with their primary regulatory authority, and to have just one set of harmonized legislative provisions to comply with.

With the entry into force of *Regulation 31-103 respecting registration requirements and exemptions* ("Regulation 31-103") on September 28, 2009, the implementation of the passport regime was for the most part completed. Thus securities regulations have been harmonized across Canada, except for the mutual fund distribution sector in Québec.

Outside Québec, the mutual fund sector is overseen by the Mutual Fund Dealers Association of Canada (MFDA) and a uniform regulation is applied. In Québec, the Autorité des marchés financiers (AMF) oversees the mutual fund distribution sector, except for the discipline and professional development of mutual fund representatives ("representatives") which fall under the purview of the Chambre de la sécurité financière ("CSF").

With a view to harmonizing its mutual fund regulation with that of the rest of Canada, the AMF held two consultation exercises in 2007 as part of the more general framework leading to the development of Regulation 31-103. After those consultations, it was agreed that:

- The MFDA shall not be recognized as a self-regulatory organization.
- The AMF will adopt those parts of the MFDA regulation that are compatible with Québec statutes and regulations in order to introduce a regulatory framework for the mutual fund sector that is harmonized with that which applies in the rest of Canada.
- The CSF will continue to be responsible for the discipline and compulsory professional development of representatives.

The AMF has allowed itself two years following the entry into force of Regulation 31-103 to complete the harmonization of regulations pertaining to the mutual fund sector, that is by September 28, 2011. It is in this context, and to uphold that commitment, that the AMF is undertaking this consultation.

This brief consists of five sections.

- Section 1 reviews the benefits to be gained by adopting a harmonized mutual fund distribution regulation in Québec.
- Section 2 presents the approach used to harmonize the compatible parts of regulations between Québec and the rest of Canada. It also examines certain issues pertaining to regulation development and the implementation of a harmonized regulation from an operational standpoint.
- Section 3 discusses the implications of harmonization for the CSF.
- Section 4 identifies the parts of the MFDA regulation that are deemed incompatible with Québec statutes and regulations and which will therefore be excluded from the new mutual fund regulation.
- Finally, Section 5 discusses some of the impacts that the adoption of the new regulation will have on Québec mutual fund dealers and representatives.

1. BENEFITS OF HARMONIZED REGULATIONS

The harmonization of mutual fund regulations is desirable from many points of view. To begin with, harmonization makes it possible for firms operating in several territories to reduce their compliance costs. In fact, harmonized regulations make it possible to maintain a single compliance system for all the territories in which a firm carries on business.

In addition, it promotes better coordination between oversight authorities while allowing healthy competition between the various markets. Finally, it enables consumers to enjoy comparable protection in any jurisdiction where they may do business.

Given the structure of the mutual fund sector in Québec, we may reasonably consider that the benefits of adopting harmonized regulations are substantial. Indeed, of the 77 mutual fund dealers in Québec, 43 have activities in other provinces or territories and therefore are already members of the MFDA. If we take into account the size of the dealers in terms of the number of representatives, we note that the 43 dealers with business outside Québec comprise 22,472 representatives, i.e. over 96% of the 23,307 representatives who are active in this sector.

The mutual fund industry in Québec (as at September 20, 2010)

	Firms	Representatives	% of the total
MFDA member firms			
- head office in Québec	9	14,654	62.9%
- head office outside Québec	34	7,818	33.5%
Subtotal	43	22,472	96.4%
Non-MFDA member firms	34	835	3.6%
TOTAL	77	23,307	100%

These data show that adopting a compatible MFDA regulation will simplify operations for many dealers that do business both in Québec and outside the province. Those dealers will no longer have to familiarize themselves and comply with two different regulations (that of the AMF and that of the MFDA) for their operations in different markets, nor will they have to devote human and financial resources to monitoring changes to two regulations.

In addition, the data show that a large part of Québec's mutual fund sector is already familiar with the MFDA regulation, which should limit the transition costs associated with its implementation.

2. IMPLEMENTATION OF A COMPATIBLE REGULATION

The establishment of a normative framework that is harmonized with that which applies to mutual fund dealers and their representatives outside Québec raises three major issues:

- Legal implementation of the normative framework
- Operational implementation of the normative framework
- Transition

2.1 LEGAL IMPLEMENTATION OF THE NORMATIVE FRAMEWORK

The MFDA is a legal entity created under Part II of the *Canada Corporations Act*. Mutual fund dealers in the rest of Canada are required under Regulation 31-103 to be members of this self-regulatory organization and to comply with its regulation pursuant to contractual obligations.

The MFDA governs the operations, practices and conduct of its members by means of three main instruments:

- **A By-law**, which defines the conditions of membership, the governance of the organization and its various powers
- **Rules** that members must abide by in conducting their business
- **Policies** that set minimum industry standards that expand on prescriptive requirements in MFDA Rules

In addition, certain forms are prescribed by Rules or Policies. The MFDA also issues clarifications regarding the application of its Rules and Policies in the form of Member Regulation Notices.

Adoption of the MFDA regulation in Québec

For the purposes of harmonizing the MFDA regulation to Québec's mutual fund sector, the AMF will propose to the Minister of Finance that regulatory force be given, through regulation, to the compatible items of the MFDA regulation as they stand on a specific date.

The adoption of the MFDA regulation will enable dealers to refer, for the most part, to a regulation that is nearly identical to that of the MFDA when setting up their compliance systems.

The main differences will pertain to Québec-specific aspects of mutual fund distribution. As was agreed following consultations carried out in 2007, the following Québec-specific aspects are maintained for mutual fund dealers and representatives registered in Québec:

- Compulsory membership of representatives in the CSF, and payment of annual dues
- The preservation of the CSF's authority with respect to discipline and compulsory professional development of representatives
- Compulsory payment of dues by dealers to the Fonds d'indemnisation des services financiers (*Financial Services Compensation Fund*)
- Maintenance of the liability insurance plan to be subscribed to by dealers and their representatives registered in Québec

Accordingly, parts of the MFDA regulation deemed incompatible with these Québec-specific factors will not be adopted.

An alternative approach would have been to incorporate the MFDA Rules that have no equivalent in Québec statutes and regulations into a new Québec regulation specifically governing mutual fund distribution. This approach would have created major difficulties, both for the regulator and the firms.

More specifically, for the sake of legal consistency, only those parts of the MFDA regulation that have no counterpart in Québec legislation could have been included in a regulation specific to the mutual fund sector.

In addition, the resulting regulation would necessarily have been very different in form from that of the MFDA, given the principles underlying the drafting of statutes and regulations in Québec.

In short, the incorporation of the MFDA regulation in a Québec regulation would have resulted in a regulation which, although similar in scope, would have been very different in form. Such differences in form could have generated interpretive difficulties for the parties subject to them. Giving regulatory force to the MFDA regulation resolves such difficulties.

MFDA Member Regulation Notices

As mentioned earlier, Member Regulation Notices provide clarifications regarding the application of certain Rules and Policies.

The AMF proposes to incorporate those MFDA notices that pertain to Rules and Policies that are compatible with Québec statutes and regulations, as AMF notices.

Coordination of regulation development with the MFDA

As indicated above, the AMF is proposing to incorporate those parts of the MFDA regulation that are compatible as of a given date into the Québec regulation. As for subsequent changes that the MFDA may make to its regulation, they will be analyzed by the AMF, which will advise the Minister of Finance as to whether it is appropriate to give them regulatory force in Québec.

A number of rules and one policy are currently subject to an amendment process from the MFDA. Should amendments be adopted by the MFDA before September 28th 2011 when the new regulation becomes effective, the AMF will then inform the mutual fund industry.

As far as the ongoing development of the MFDA regulation is concerned, the AMF intends to collaborate actively in that process. Coordinated regulation development constitutes the Cooperation Agreement entered into by the AMF, the CSF and the MFDA in 2004. The Agreement calls for the AMF and the MFDA to collaborate in the regulation development process with the goal of having substantially similar regulatory systems, in the interest of the public, the dealers and their clients.

Although mutual fund regulations will be extensively harmonized, the fact remains that the regulation will be administered by different organizations. There will therefore be a risk of varying interpretations or applications. The AMF and the CSF will work together with the MFDA to minimize that risk.

Work will be undertaken to expand the scope of the 2004 Agreement between the AMF, the CSF and the MFDA.

2.2 OPERATIONAL IMPLEMENTATION

In order for Québec's industry to gain maximum benefit from the harmonization of mutual fund regulations, it must be accompanied by stronger coordination of operational activities between the AMF and the MFDA.

Coordination of inspections with the MFDA

Under the 2004 Agreement mentioned earlier, the AMF and the MFDA endeavour to coordinate inspections, but there are currently limits to this coordination.

Since the inspection focuses on compliance with regulations that are currently different, the AMF and MFDA cannot be satisfied with each other's inspection. Furthermore, it is difficult, even after a coordinated inspection, to prepare a single inspection report and to follow up on the inspection in a coordinated manner.

Once the regulations have been harmonized, discussions will be undertaken with the MFDA to improve this coordination with the goal of minimizing the operational impacts borne by dealers operating in more than one jurisdiction.

Document filings with the MFDA and the AMF

The coordination between the AMF and the MFDA could also extend to the documents required to be filed under the regulations. For example, dealers that are registered in Québec and outside Québec

currently must produce two different financial reports, one for the MFDA and one for the AMF. In a harmonized environment, efforts would be undertaken with the MFDA to facilitate the filing of financial reports by dealers operating in more than one jurisdiction.

2.3 TRANSITION

The harmonization of mutual fund regulations will have impacts on the dealers, particularly those that currently operate only in Québec and that are not familiar with the MFDA regulation.

Therefore, the AMF intends to adopt appropriate transition periods to give those dealers, as well as MFDA member dealers that had not yet harmonized their compliance systems across Canada, a chance to carry out the necessary changes and bear the cost of setting up the new framework in Québec.

The proposed transition periods are set out in Section 4 of this brief and summarized in table A1 attached hereto.

3. IMPLICATIONS FOR THE CHAMBRE DE LA SÉCURITÉ FINANCIÈRE

An Act respecting the distribution of financial products and services (ARDFPS) gives the CSF the mission of protecting the public by maintaining the discipline of its members and overseeing their training and ethics.

When the mutual fund sector was transferred from the *ARDFPS* to the *Securities Act* on September 28, 2009, the CSF's entire mission with respect to mutual fund representatives was kept intact.

Thus the CSF's mandate with respect to mutual fund representatives remains unchanged, and the CSF retains its role on the discipline and compulsory professional development of those representatives.

The most significant impact of the transfer of the mutual fund sector from the *ARDFPS* to the *Securities Act* on the CSF and the representatives is the repeal of the *Regulation respecting the rules of ethics in the securities sector* on September 28, 2009. Nevertheless, under section 135 of *An Act to amend the Securities Act and other legislative provisions*, sections 2 through 20 of that regulation continue to apply to mutual fund representatives, among others, until such time as a regulation issued under the *Securities Act* determines, for them, rules equivalent to those set out in those sections.

Sections 2 through 20 of that regulation shall therefore cease to apply with the entry into force of the regulation adopting a compatible MFDA regulation on September 28, 2011. The rules of ethics applicable to mutual fund representatives will be contained in the compatible MFDA regulation. Both the CSF and the representatives will be required to familiarize themselves with the new regulation.

4. REGULATION INCOMPATIBLE WITH QUÉBEC STATUTES AND REGULATIONS

As mentioned earlier, all parts of the MFDA regulation that are deemed incompatible with Québec-specific factors will be excluded from the new mutual fund regulation. The incompatible parts are listed in table A2, attached hereto, and examined in detail in the pages that follow.

An administrative version of the MFDA regulation may be found in appendix A3.

MFDA By-law No. 1

The MFDA currently has only one by-law, which is discussed in this section.

All of By-law No. 1 is deemed incompatible, with the exception of the definitions of the following terms contained in Section 1:

- affiliate or affiliated corporation
- associate
- branch office
- carrying dealer
- client name
- control or controlled
- guaranteeing
- individual
- introducing dealer
- mutual fund dealer
- nominee name
- ownership interest
- person
- related Member
- securities dealer
- securities related business
- sub-branch
- subsidiary

The above definitions are necessary because these terms are used in the MFDA Rules and Policies that are deemed compatible.

MFDA Rules

With respect to MFDA Rules, the parts deemed incompatible are as follows:

Rule 1.1.4 Employees

Paragraph (c) of Rule 1.1.4 calls for mutual fund dealers to be liable to third parties for the acts and omissions of employees.

That paragraph is deemed incompatible with the system of civil law liability.

Rule 1.1.5 Agents

Paragraph (c) of Rule 1.1.5 calls for mutual fund dealers to be liable to third parties for the acts and omissions of agents.

That paragraph is deemed incompatible with the system of civil law liability.

Paragraph (e) of Rule 1.1.5 calls for mutual fund dealers that are members of the MFDA to maintain financial institution bonds and insurance policies covering the agent's conduct.

That paragraph is deemed incompatible with section 193 of the *Securities Regulation* which requires mutual fund dealers registered in Québec to maintain liability insurance in keeping with the requirements set out in section 194 of the *Securities Regulation*. Section 193 also requires mutual fund dealers to ensure that any agent acting on their behalf who is not one of their employees is covered by liability insurance in accordance with the requirements set out in section 195 of the *Securities Regulation*.

Rule 1.1.6 Introducing and Carrying Arrangement

Subparagraphs (vi) and (vii) of paragraph (b) of this Rule require both the introducing dealer and the carrying dealer to maintain financial institution bonds and insurance policies.

Those subparagraphs are deemed incompatible with section 193 of the *Securities Regulation* which requires mutual fund dealers registered in Québec to maintain liability insurance in keeping with the requirements set out in section 194 of the *Securities Regulation*.

Rule 1.2.1 Salespersons

Paragraph (b) Compliance with MFDA Requirements

Paragraph (b) of Rule 1.2.1 requires that mutual fund representatives who conduct business on behalf of an MFDA member dealer must sign the prescribed agreement, entitled “Agreement of Approved Person” in which they agree, among other things, to be subject to the By-laws, Rules and Policies of the MFDA.

The signing of such an agreement is necessary because the MFDA is an association, and its regulatory instruments can be imposed only on people who have agreed to be subject thereto.

The signing of such an agreement is not necessary in conjunction with the adoption of compatible MFDA rules by the AMF because, once adopted, the rules will have regulatory force upon the mutual fund dealers and their representatives.

Paragraph (c) Training and Supervision

Paragraph (c) of Rule 1.2.1 requires, among other things, that newly registered representatives complete a training program within 90 days of commencing to trade or deal in securities on behalf of a mutual fund dealer that is a member of the MFDA.

The part of paragraph (c) of Rule 1.2.1 and the part of MFDA Policy No. 1 “New Registrant Training and Supervision” that deal with the training program are deemed incompatible with the *Regulation of the Chambre de la sécurité financière respecting compulsory professional development* which sets out the professional development requirements that apply to mutual fund representatives who are registered with the AMF.

Paragraph (d) Dual Occupations

Paragraph (d) of Rule 1.2.1 sets out the conditions under which a representative may have another gainful occupation.

Subparagraph (vii) of paragraph (d) of that Rule sets out the conditions that must be met by a mutual fund representative to provide financial planning services otherwise than through the dealer.

This subparagraph is deemed incompatible with the *ARDFPS* provisions on financial planning.

Rule 1.2.2 Branch Managers

Paragraph (c) of Rule 1.2.2 calls for each branch manager to be registered as such under the applicable securities legislation.

This paragraph is deemed incompatible because the branch manager registration category has ceased to exist in securities regulations since Regulation 31-103 came into force on September 28, 2009.

Rule 1.2.3 Trading Partners, Directors, Officers and Compliance Officers

Rule 1.2.3 sets out the courses that trading partners, directors, officers and compliance officers must have successfully completed, as well as the requirement that they be registered with the securities authority.

Since the MFDA is not responsible for the registration of individuals, Rule 1.2.3 is deemed incompatible.

Rule 1.2.4 Currency of Courses

Rule 1.2.4 sets out the duration of the validity of courses in order for an individual to register with the securities authority, and the MFDA's authority to grant exemptions.

Since the MFDA is not responsible for the registration of individuals, Rule 1.2.4 is deemed incompatible.

Rule 1.2.5 Reporting Requirements

Rule 1.2.5 sets out the matters that the dealer must report to the MFDA and those that the representative must report to the dealer.

Policy No. 6 "Information Reporting Requirements" sets out the minimum requirements regarding matters that the representative must report to the dealer and those that the dealer must report to the MFDA under Rule 1.2.5.

This Rule and this Policy are deemed incompatible with the reporting requirements set out in the *Securities Act*, the *Securities Regulation*, Regulation 31-103 and *Regulation 33-109 respecting registration information*.

Rule 2.1.2 Member Responsible

Rule 2.1.2 calls for mutual fund dealers to be liable for the acts and omissions of their representatives and other employees and agents.

This Rule is deemed incompatible with the system of civil law liability.

Rule 2.4.1 (c) – Arrangements Prohibited

According to paragraph (b) of Rule 2.4.1, the dealer may pay the remuneration owed to a representative acting as agent for the dealer to an unregistered corporation, subject to certain conditions. Paragraph (c) states that paragraph (b) does not apply to remuneration derived from client in Alberta.

Since the AMF has no jurisdiction over business conducted in Alberta, paragraph (c) is deemed incompatible.

Rule 2.11 Complaints

Rule 2.11 calls for mutual fund dealers to keep a log of complaints and set policies and procedures for handling complaints. MFDA Policy No. 3 "Complaint Handling, Supervisory Investigations and Internal Discipline" sets out minimum standards for developing and applying such procedures.

Rule 2.11 is incompatible with sections 168.1.1 through 168.1.3 of the *Securities Act* which set out the dealers' obligations with regard to the handling of complaints.

MFDA Policy No. 3 is also deemed incompatible with sections 168.1.1 through 168.1.3 of the *Securities Act*, with the following exceptions:

- Section 10 “Settlement Agreements” of Part I “Complaints”
- Part III “Supervisory Investigations”
- Part IV “Internal Discipline”
- Part V “Record Retention”

Rule 3.5.4 Assessments

Rule 3.5.4 imposes additional assessments to be paid by mutual fund dealers that require excessive attention from the MFDA, or that file reports late.

This Rule is deemed incompatible with Québec’s regulation pertaining to fees which sets out all of the charges payable by a dealer.

Rule 4 Insurance

Rule 4 requires that mutual fund dealers that are members of the MFDA maintain a Financial Institution Bond.

This Rule is deemed incompatible with sections 193, 194 and 195 of the *Securities Regulation* which require that mutual fund dealers and representatives registered in Québec maintain liability insurance.

5. IMPACTS OF THE ADOPTION OF A COMPATIBLE MDFA REGULATION

As mentioned earlier, a large number of the mutual fund dealers that conduct business in Québec are already familiar with the MFDA regulation and should be able to quickly adjust to the new regulation. The impact could be more serious for dealers that operate only in Québec, and that are not familiar with the new regulation. Consequently, the AMF intends to adopt appropriate transition periods to enable those dealers, and the MDFA member dealers that had not harmonized their compliance system to meet the pan-Canadian requirements, to make the necessary changes and bear the costs of setting up the new framework in Québec.

The remainder of this section lists certain impacts that the adoption of a compatible MDFA regulation could have on mutual fund dealers and their representatives, or on some of them.

Rule 1.1.1 Members

Paragraph (a)

Paragraph (a) of Rule 1.1.1 requires that all securities-related business be carried on for the account of the dealer, through the facilities of the dealer (except as expressly provided for in the Rules).

In this way, all of the representative’s securities-related business will be subject to the supervision program set up by the dealer to ensure that the representative complies with regulatory requirements and with the dealer’s policies and procedures.

The application of this Rule could have an impact on the business model of those mutual fund dealers that do not currently require that all of their representatives’ securities-related business be carried out through them. Those dealers generally require that only transactions in mutual fund securities be carried out through them.

To enable the dealers to adjust their policies and procedures and establish them so that it becomes compulsory for all of their representatives' securities-related business to be carried out through them, the AMF proposes to grant a transition period of six months.

Paragraph (b)

Paragraph (b) of Rule 1.1.1 calls for all the revenues generated by any business engaged in by a dealer to be paid directly to the dealer and recorded in its books.

Québec's current regulation does not include a requirement that payment go through the dealer before being handed over to the representative. The purpose of this requirement is to enable the dealer to maintain better control over its representatives by enabling it to detect any unauthorized activities that may be carried out by a representative.

The application of this Rule could have an impact on the business model of dealers that do not currently require that all revenues arising from business engaged in on the dealer's behalf be paid to it directly.

To enable the dealers to revise their policies and procedures and establish them so that all the revenues generated by a dealer's business are paid to it directly and recorded in its books, the AMF proposes to grant a transition period of six months.

Paragraph (c)

Paragraph (c) of Rule 1.1.1 defines the types of relationship that can exist between the mutual fund dealer and any person conducting securities-related business on account of the dealer.

Subparagraphs (i) and (ii) of paragraph (c) of Rule 1.1.1 state that the representative may be an employee or an agent of the dealer. Rules 1.1.4 and 1.1.5 set out the responsibilities of each of those parties.

The concepts of employee and agent currently exist in Québec from an administrative point of view, with the status of employee and agent.

Subparagraph (iii) of paragraph (c) of Rule 1.1.1 presents the concepts of introducing dealer and carrying dealer. Rule 1.1.6 provides more details about the conditions and terms of introducing and carrying arrangements.

Introducing and carrying arrangements are currently not reflected in Québec's regulation.

The application of this Rule could have an impact on mutual fund dealers that will have to comply with the conditions and requirements surrounding the concepts of employee and agent and introducing and carrying arrangements.

The AMF proposes to grant a six-month transition period to enable the dealers to comply with these conditions and requirements.

Rule 1.1.7 Business Names, Styles, Etc.

Rule 1.1.7 sets out the various terms, conditions and requirements concerning the names used by dealers and representatives.

Paragraph (d) of this Rule requires that a dealer notify the MDFA before using any business or style or trade name other than the dealer's legal name.

Section 3.1 of *Regulation 33-109 respecting registration information* requires dealers to notify the regulator within 30 days of starting to use another name.

The application of this Rule could have an impact on mutual fund dealers that will have to revise their policies and procedures in order to notify the AMF before using another name.

Rule 1.2.1 Salespersons

Paragraph (c) Training and Supervision

Paragraph (c) of Rule 1.2.1 requires, among other things, that newly registered representatives be subject to a six-month supervision period.

The intention of this Rule is that dealers should closely supervise their new representatives in order to have reasonable assurance that they are able to carry out their duties appropriately, and that dealers should provide additional coaching or remedial training, if necessary.

The application of this Rule could have an impact on some mutual fund dealers' current supervision programs.

Rule 1.2.2 Branch Managers

Paragraphs (a) and (b) of Rule 1.2.2 set out the proficiencies and experience required of persons holding the position of branch manager.

Under Regulation 31-103, each dealer is responsible for setting up a compliance system and for providing sufficient resources to run an efficient system, which includes having qualified individuals with the power and the responsibility to monitor compliance.

Since Québec's current regulation does not specifically set out the proficiencies and experience required of human resources assigned to on-site supervision in the branch offices, the application of this Rule could have an impact on the human resources of some mutual fund dealers that have not imposed such requirements.

The AMF is proposing a two-year transition period to enable individuals holding the position of branch manager to acquire the experience required. A one-year transition period is proposed to enable those individuals, including those holding the position of alternate branch manager, to pass the examinations of the required courses.

Rule 2.2 Client Accounts

Rule 2.2 sets out the obligations of mutual fund dealers and their representatives with respect to the supervision of client accounts.

MFDA Policy No. 2 "Minimum Standards for Account Supervision" provides clarifications regarding the application of Rule 2.2 and sets out minimum standards for the supervision of client accounts, both at the branch offices and at the head office.

The application of Policy No. 2 will have an impact on some dealers, which will have to upgrade their supervision systems to meet the minimum standards. The AMF is proposing a two-year transition period to enable the dealers to implement minimum supervision standards.

Policy No. 5 "Branch Review Requirements" sets out minimum standards for the development and application of branch and sub-branch office inspection procedures by dealers.

The application of this Policy will have an impact on some dealers, which will have to upgrade their supervision systems to meet the minimum standards, including the inspection of branch offices.

The AMF is proposing a two-year transition period to enable the dealers to set up an inspection program that meets the minimum standards.

Rule 2.2.4 Updating Know-Your-Client Information

Paragraph (a) of Rule 2.2.4 sets out the circumstances in which the Know-Your-Client information must be updated.

Paragraph (b) of Rule 2.2.4 requires dealers to at least annually, in writing, ask each client to notify the dealer if the Know-Your-Client information previously provided to the dealer or the client's circumstances have materially changed. Some dealers comply with this requirement by including an appropriate notice on the statements of account that are sent to clients.

This MFDA Rule is less strict than the reminder from the AMF's Inspection Department, contained in a letter dated July 29, 2005 to all mutual fund dealers. That reminder specified that the new account application form must be updated upon the occurrence of one of two events, whichever happens first:

- before the next transaction, if more than a year has elapsed since the last update;
- after two years.

This reminder from the Inspection Department is available on the AMF's website through the following link:

<http://www.lautorite.qc.ca/userfiles/File/intervenant-secteur-financier/obligations-formalites/Rappel-obligations.pdf>

The adoption of paragraph (b) of Rule 2.2.4 will lighten the regulatory burden for mutual fund dealers and their representatives, since a systematic update of new account application forms will be replaced with the sending of an annual notice to clients and an update when necessary.

Rule 2.4.1 (b) Payment of Commissions to Unregistered Corporation

Paragraph (a) of Rule 2.4.1 requires that the mutual fund dealer pay directly to the representative any remuneration in respect of business conducted by the representative on the dealer's behalf.

Paragraph (b) of Rule 2.4.1 allows the dealer to pay the remuneration owed to a representative who acts as agent for the dealer to an unregistered corporation, subject to certain conditions.

This practice is not currently allowed in Québec.

The adoption of paragraph (b) of Rule 2.4.1 will lighten the regulatory burden of dealers and their representatives, since the payment of remuneration to an unregistered corporation will be permitted, subject to certain conditions.

Rule 2.4.3 Service Fees or Charges

Rule 2.4.3 prohibits dealers from imposing on any client or deducting from the account of any client any service fee or service charge unless written notice is given to the client on the opening of the account or at least 60 days prior to the imposition or revision of the fee or charge.

Québec's current regulation does not require any such notice to clients.

The application of this Rule could have an impact on mutual fund dealers, which may be obliged to revise their policies and procedures in order to introduce this notice.

Rule 2.5.3 Branch Manager

Paragraph (a) of Rule 2.5.3 calls for each of a dealer's branch offices where its business is conducted to be supervised by a Branch Manager. Normally, the Branch manager must be on site if the office is staffed by four representatives or more. An office with fewer than four representatives may be supervised by a Branch manager who is not usually present in that office.

Paragraph (b) of Rule 2.5.3 defines the responsibilities of the Branch manager which are to ensure that the business conducted by the representatives is compliant with the regulations, and to supervise the opening of new accounts and trading activity at the branch offices for which he or she is responsible.

Paragraph (c) of Rule 2.5.3 calls for the appointment of alternate branch managers who shall fulfill the responsibilities of the Branch manager in the event of a temporary absence. Alternate branch managers are not required to be normally present at the branch office.

As it currently stands, Québec's regulation makes the dealer responsible for setting up a compliance system and allocating sufficient resources to run the system efficiently, including having qualified individuals with the power and responsibility to supervise compliance.

The application of this Rule could have an impact for dealers that have not already set up the concepts of branch manager and alternate branch manager, and of branch offices and sub-branch offices.

The AMF is proposing a three-month transition period to allow the dealers to identify their branch offices and sub-branch offices and to appoint branch managers and alternates.

Rule 2.6 Borrowing for Securities Purchases

Rule 2.6 requires dealers to provide each client with a disclosure document discussing the risks associated with borrowing for the purpose of buying securities, at the time of opening an account and whenever a representative makes a recommendation for purchasing securities by borrowing, or otherwise becomes aware of a client borrowing monies for the purpose of investment. The MFDA has prepared two separate disclosure documents: one short, the other detailed.

Québec's current regulation calls for mutual fund representatives to give a disclosure document to potential buyers of mutual fund securities who plan to borrow funds to pay for their purchase. No delivery of a disclosure document is required at the opening of an account. The form prescribed by the regulation is different from the forms in use at the MFDA.

The application of the MFDA Rule will have an impact on dealers which will have to revise their policies and procedures to require the delivery of one of the two forms prescribed by the MFDA when an account is opened, and to replace the form they currently use with one or both prescribed forms.

The AMF is proposing a three-month transition period to allow dealers to revise their policies and procedures.

Rule 2.7.3 Review Requirements

Rule 2.7.3 states that no advertisement or sales communication shall be issued unless first approved by a resource of the dealer's who has been designated as being responsible for advertisements and sales communications.

The application of this Rule could have an impact on some dealers, which will have to revise their policies and procedures to introduce this prior approval process.

Rule 2.9 Internal Controls

Rule 2.9 calls for all mutual fund dealers to establish and maintain appropriate internal controls.

MFDA Policy No. 4 “Internal Control Policy Statements” provides information about how to comply with the requirements of Rule 2.9.

The application of this Rule and this Policy could have an impact on some dealers, which will have to revise their internal controls.

Rule 2.10 Policies and Procedures Manual

Rule 2.10 requires that each mutual fund dealer establish and maintain written policies and procedures for dealing with clients and ensuring compliance. It also stipulates that said policies and procedures must be approved by the dealer’s senior management.

The application of this Rule could have an impact on some dealers, which will have to revise their policies and procedures in order to introduce the approval by senior management.

Rule 2.11 Complaints

Rule 2.11 deals with the handling of complaints and is deemed incompatible with sections 168.1.1 through 168.1.3 of the *Securities Act*.

MFDA Policy No. 3 “Complaint Handling, Supervisory Investigations and Internal Discipline” is also deemed incompatible with sections 168.1.1 through 168.1.3 of the *Securities Act* with the following exceptions:

- Section 10 “Settlement Agreements” of Part I “Complaints”
- Part III “Supervisory Investigations”
- Part IV “Internal Discipline”
- Part V “Record Retention”

The application of the compatible parts of Policy No. 3 could have an impact on some mutual fund dealers, which will have to revise their policies and procedures in order to introduce the requirements set out in those provisions.

Rule 3.1.1 Minimum Levels

Rule 3.1.1 prescribes the minimum amount of capital that must be maintained by mutual fund dealers, which is \$25,000, \$50,000, \$75,000 or \$200,000 depending on whether the dealer is considered to be in level 1, 2, 3 or 4. Québec’s current regulation calls for mutual fund dealers to have a minimum capital of \$50,000.

The application of this Rule will have an impact on the minimum capital maintained by some dealers.

Dealers that are considered to be in Level 1 will have their minimum capital requirement reduced from \$50,000 to \$25,000, lightening the regulatory burden for them.

The AMF is proposing a one-year transition period to enable level 3 dealers that are not members of the MFDA to meet the capital requirement of \$75,000.

The AMF is proposing a three-year transition period to enable level 4 dealers that are not members of the MFDA to gradually meet the capital requirement of \$200,000 according to the following timetable:

- by September 30, 2012 \$100,000

- by September 30, 2013 \$150,000
- by September 30, 2014 \$200,000

Rule 3.2.4 Related Member Guarantees

Rule 3.2.4 stipulates that every mutual fund dealer is responsible for, and must guarantee, the obligations to clients incurred by each of its related dealers.

The application of this Rule will have an impact on dealers that are not members of the MFDA and that will have to introduce a guarantee.

The AMF is proposing a six-month transition period to enable dealers that are not members of the MFDA to implement the required guarantee.

Rule 3.4 Early Warning

Rule 3.4 sets out the situations in which a mutual fund dealer is considered as being in an early warning position with respect to its capital, profitability and liquidity position, and the special provisions that apply to such a dealer.

The application of Rule 3.4 could have an impact on the business of a dealer that triggers the early warning.

The AMF is proposing a two-year transition period for applying the special provisions relating to an early warning situation for dealers that are not members of the MFDA. This period will enable the dealers to familiarize themselves with the new requirements regarding early warning and capital in advance of the automatic application of the special provisions set out in the Rule. Despite this transition period, the AMF reserves the right to ask a dealer to provide financial information, and to impose the special provisions described in the Rule on the dealer in the event that such action is warranted to protect the public.

Rule 3.5.1 Monthly and Annual (Filings)

Rule 3.5.1 calls for dealers to file a financial questionnaire and report with the MFDA every month, whereas Québec's current regulation calls for a bimonthly report on net liquid capital to be filed every two months. Moreover, the content of the MFDA report is different from that required by the AMF.

The application of this Rule will have an impact on dealers, which will have to adopt the new financial report and file it more frequently.

The AMF is proposing a two-year transition period to enable the dealers that are not members of the MFDA to comply with the requirement for monthly filing of financial documents. During the transition period, the AMF will ask the dealers to file their financial reports quarterly (rather than bimonthly as called for by the current regulation), but it reserves the right to require at any time that such reports be filed more frequently during that period if the dealer's situation so warrants.

Quarterly filings will enable the dealers that are not members of the MFDA to familiarize themselves with the new financial report.

APPENDIX

Table A1: Proposed transition periods¹

MFDA Rule	Subject	Transition Period
1.1.1 (a)	All securities-related business through the facilities of the dealer	6 months
1.1.1 (b)	All the revenues generated by a dealer's business are paid to the dealer	6 months
1.1.1 (c)	The types of relationship that can exist between the dealer and any person	6 months
1.1.2	Proficiencies of branch managers	1 year
1.1.2	Experience of branch managers	2 years
2.2	Minimum supervision standards	2 years
2.2	Inspection of branch offices	2 years
2.5.3	Identification of branch offices and sub-branch offices, and appointment of branch managers and alternates	3 months
2.6	Delivery of the disclosure document on leveraging upon account opening, and replacement of the current form	3 months
3.1.1	Minimum capital of \$75,000 for a level 3 dealer	1 year*
3.1.1	Minimum capital of \$200,000 for a level 4 dealer according to the following timetable: <ul style="list-style-type: none"> • by September 30, 2012 \$100,000 • by September 30, 2013 \$150,000 • by September 30, 2014 \$ 200,000 	3 years*
3.2.4	Guarantee concerning related dealers	6 months*
3.4	Early warning	2 years*
3.5.1	Monthly filing of financial documents	2 years*

* Transition applicable to dealers that are not members of the MFDA

¹ Each proposed transition period shall start on the date of entry into force of the regulation giving regulatory force to the MFDA regulation.

APPENDIX

Table A2: Incompatible regulation

Incompatible MFDA By-law	
By-law No. 1	<p>All of By-law No. 1, except for the definitions of the following terms, found in Section 1:</p> <ul style="list-style-type: none"> • affiliate or affiliated corporation • associate • branch office • carrying dealer • client name • control or controlled • guaranteeing • individual • introducing dealer • mutual fund dealer • nominee name • ownership interest • person • related Member • securities dealer • securities related business • sub-branch • subsidiary
Incompatible MDFA Rules	
Rule 1.1.4	Paragraph (c) dealing with liability to third parties
Rule 1.1.5	Paragraph (c) dealing with liability to third parties
Rule 1.1.5	Paragraph (e) dealing with financial institution bonds and insurance policies
Rule 1.1.6	Subparagraphs (vi) and (vii) of paragraph (b) pertaining to financial institution bonds and insurance policies
Rule 1.2.1	Paragraph (b) dealing with the signing of the “Agreement of Approved Person” form by representatives
Rule 1.2.1	The part of paragraph (c) dealing with the training program
Rule 1.2.1	Subparagraph (vii) of paragraph (d) dealing with the offer of financial planning services
Rule 1.2.2	Paragraph (c) dealing with the registration of branch managers
Rule 1.2.3	The entire Rule dealing with the proficiencies and registration of trading partners, directors, officers and compliance officers
Rule 1.2.4	The entire Rule dealing with the duration of the validity of courses and authority for exemptions
Rule 1.2.5	The entire Rule dealing with the matters that the dealer must report to the MFDA and those that the representative must report to the dealer
Rule 2.1.2	The entire Rule dealing with liability to third parties
Rule 2.4.1	Paragraph (c) dealing with remuneration derived from a client in Alberta
Rule 2.11	The entire Rule dealing with the handling of complaints
Rule 3.5.4	The entire Rule dealing with additional assessments to be paid by dealers
Rule 4	The entire Rule dealing with the financial institution bond

Incompatible MDFA Policies	
Policy No. 1	The part of the Policy dealing with the training program
Policy No. 3	Most of the policy, with the exception of: <ul style="list-style-type: none"> • Section 10 “Settlement Agreements” of Part I “Complaints” • Part III “Supervisory Investigations” • Part IV “Internal Discipline” • Part V “Record Retention”
Policy No. 6	The entire Policy dealing with the matters that dealers must report to the MFDA and those that representatives must report to the dealer