



**AUTORITÉ
DES MARCHÉS
FINANCIERS**

**SECOND CONSULTATION ON THE
REGULATORY FRAMEWORK
APPLICABLE TO THE MUTUAL FUND SECTOR
FURTHER TO THE
REGISTRATION REFORM PROJECT**

September 21, 2007

October 5, 2007 - Revised version

1. CONTEXT

Part of the mission of the *Autorité des marchés financiers* (“AMF”) is to provide assistance to consumers of financial products and supervise activities connected with the distribution of these products.

First consultation

To help fulfill its mission, on February 20, 2007, the AMF conducted a consultation with mutual fund firms (also known as group savings plan firms), their representatives and a number of stakeholders from the industry concerning the impact of registration reform (“reform”). This consultation was carried out by means of a proposal document published on February 20, 2007 (the “first proposal document”). The period for public comment on the first proposal document ended on May 25, 2007.

Regulation 31-103

This reform is being proposed under draft *Regulation 31-103 respecting registration requirements* (“Regulation 31-103”), first published for public comment also on February 20, 2007. The public comment period for draft Regulation 31-103 ended on June 30, 2007.¹ A second draft Regulation 31-103 will be published in fall 2007. Implementation of Regulation 31-103 is expected to take place in 2008.

Purpose of reform

As part of its participation in the work carried out by the Canadian Securities Administrators (“CSA”), the AMF’s objective is to modernize the current registration regime applicable to securities intermediaries, thereby helping to meet the need for harmonization and simplification.

This harmonization, modernization and simplification of the registration regime forms part of the framework of the passport registration system that is scheduled for implementation in 2008 concomitant with the coming into force of Regulation 31-103.

The recommendations in this document are the result of the AMF’s consultation process. The AMF is soliciting comments on these recommendations until **November 19, 2007**.

2. AMF RECOMMENDATIONS

Proposed framework

After analyzing comments on the first proposal document, the AMF recommends modifying the framework applicable to the mutual fund sector as follows:

1. Mutual fund firms would not be required to join an industry self-regulatory organization (“SRO”) in Québec.
2. At the end of a two-year transition period following the coming into force of Regulation 31-103,² mutual fund firms and their representatives would be subject to compatible³ rules of the Mutual Fund Dealers Association of Canada (MFDA), even though the MFDA is not recognized in Québec under the *Act respecting the Autorité des marchés financiers* (“AMF Act”).

¹ The first proposal document, draft Regulation 31-103 and related documents, including comments received, are available on the AMF website at <http://www.lautorite.qc.ca/projets-speciaux/reforme-inscription.en.html>.

² In July 2010, assuming Regulation 31-103 comes into force in July 2008.

³ Compatible with Québec laws and regulations.

3. Mutual fund representatives registered in Québec would continue to be members of the *Chambre de la sécurité financière* (the “CSF”) and to pay the mandatory annual contribution.
4. The regime for mandatory annual contributions paid by firms to the Financial Services Compensation Fund (FSCF), based on the number of representatives of the firm, would not be amended for mutual fund firms registered in Québec.
5. The liability insurance regime for mutual fund firms and their representatives registered in Québec would not be amended.
6. Annual fees for maintaining registration of mutual fund dealer firms registered in Québec, whether or not they are MFDA members, would be amended to cover the costs of supervising and overseeing mutual fund dealer firms.
7. The second paragraph, section 149 of the *Securities Act* (“SA”), which restricts a representative of a dealer with an unrestricted practice from concurrently carrying on business as such and being employed by a financial institution, unless the representative is specialized in group savings or scholarship plans, would not be amended.

Passport registration system

The passport registration system, as set out under proposed *Regulation 11-102 respecting Passport System*⁴ (the “passport system”), is based on harmonized provisions of draft Regulation 31-103. The passport system enables firms or individuals who are or will be registered in their principal jurisdiction to register in jurisdictions other than their principal jurisdiction simply by filing a notice with their principal regulator.

Under the passport system, registered representatives with main offices in Québec would be required to be members of the CSF and hold liability insurance. Mutual fund dealers registered in Québec also would be required to hold insurance that covers their liability in Québec.

Consequently, representatives who are registered in Québec but have their main offices outside Québec and dealers who are registered in Québec but have no offices there would not be subject to these requirements.

Legislative amendments

The SA as well as the *Act respecting the distribution of financial products and services* (“Distribution Act”) will need to be amended to implement registration reform. Provisions of the Distribution Act relating to membership in the CSF, the FSCF and liability insurance would remain applicable to mutual fund dealers and their representatives, as the case may be.

3. ANALYSIS OF RECOMMENDATIONS

3.1 Mutual fund firms would not be required to join an industry SRO in Québec

In its first proposal document, the AMF presented discussion points regarding three options relating to recognition of a mutual fund industry SRO in Québec: 1) recognition of the MFDA as an exclusive industry SRO for firms and, indirectly, representatives; 2) recognition of the MFDA but with outsourcing of functions relating to representatives to the CSF; and 3) recognition of the CSF as an exclusive industry SRO for firms and representatives.

No consensus emerged in comments received on these three options. The AMF therefore does not propose recognizing a mutual fund SRO in Québec.

⁴ Published in the AMF Bulletin on March 30, 2007 (Vol. 4, No. 13).

However, before Regulation 31-103 comes into force, the AMF intends to publish for comments a draft regulation for the adoption of compatible MFDA rules. The AMF consequently would have an increased administrative burden relating to administration of the early warning system,⁵ inspections and compliance with the new regulatory framework. This would result in an increase in annual fees for maintaining registration.⁶

3.2 At the end of a two-year transition period following the coming into force of Regulation 31-103, mutual fund firms and their representatives would be subject to compatible MFDA rules, even though the MFDA is not recognized in Québec.

Adoption of a local regulation

The AMF recommends adoption of a local consequential regulation (the “local regulation”) for the purpose of adopting MFDA rules⁷ that are compatible with Regulation 31-103 and Québec regulations (“compatible rules”), including the MFDA *Financial Questionnaire and Report*.

This local regulation would come into force at the end of a two-year transition period following the coming into force of Regulation 31-103. It would, however, be published for comments before Regulation 31-103 comes into force.

Policy statements and member regulatory notices of the MFDA and relating to compatible rules would be adopted as a policy statement to the local regulation. The local regulation would be amended on a regular basis to reflect MFDA changes to the rules adopted by the AMF.

Objective

The objective underlying the adoption of compatible MFDA rules is to establish a normative framework that is harmonized with the framework that currently applies to mutual fund dealers outside Québec.

Summary of compatible and incompatible MFDA rules

For information purposes and on a preliminary basis, the AMF has identified rules that appear to be compatible as well as those which would not be, with Regulation 31-103 and Québec regulations. A summary of this analysis follows.

Rules 1.1.1, 1.1.3, 1.1.4, 1.1.5⁸ and 1.1.6,⁹ which relate to the structure of the mutual fund dealer firm, would be adopted. These provisions essentially ensure that mutual fund dealers and approved persons (representatives and partners who trade or deal in securities) do not carry on securities related activities other than through the dealer itself. The relationship between the mutual fund dealer and any person in a securities operation may be that of employer/employee, principal/agent, and introducing dealer/carrying dealer.

⁵The firm would be required to file the Financial Questionnaire and Report with the AMF for calculating the amount of regulatory capital to be maintained at all times. It may find itself in an early warning situation, which immediately gives rise to sanctions and recovery plans, if a) its risk-adjusted capital is less than zero (capital), b) its surplus for purposes of the early warning signal is less than zero (liquidity), and c) its risk-adjusted capital at the time of the calculation is less than its net loss (before bonuses, taxes, income taxes, and extraordinary items) for the last quarter (profitability).

⁶ See Appendix A.

⁷ With necessary amendments, particularly to replace MFDA references with AMF references. Rules, policies, and regulatory notices for MFDA members are available at www.mfda.ca.

⁸ Excluding subparagraphs d) and e), relating to minimum insurance pursuant to Rule 4 and the conduct of the agent.

⁹ Excluding subparagraphs b) vi) and vii) relating to minimum insurance to be maintained by the introducing dealer and carrying dealer pursuant to Rule 4.

Rule 1.1.7 governs mutual fund dealer *denominations and business names*. The *Guide: Rules respecting representations, banners, and business cards*¹⁰ would be amended but still allow mutual fund dealers whose activities are multidisciplinary to continue identifying themselves as “financial services firms.” Rule 1.2, which pertains to proficiency requirements for representatives, branch managers and partners who trade or deal in securities, would be adopted.¹¹

Rule 2 governs *business conduct* of mutual fund dealers. Some aspects of this rule (for example, conflicts of interest, referral arrangements, and complaint handling) are already covered in Regulation 31-103 or, as the case may be, Québec regulations, and therefore would not be adopted as part of a local regulation.

However, a number of sections of Rule 2 are compatible and would be adopted by the AMF: the general standards of conduct set forth in section 2.1.1; the responsibility of the mutual fund dealer set forth in section 2.1.2; the requirement to keep client information confidential, set forth in section 2.1.3; provisions relating to client accounts (section 2.2); provisions of section 2.3 relating to power of attorney and limited trading authorizations; minimum standards of supervision, set forth in section 2.5; advertising and sales communications (section 2.7); client communications (section 2.8); and provisions relating to transfers of account (section 2.12.1).

Section 2.4.1, which prohibits the payment of a *representative’s commission* to any person other than the representative, is currently the subject of a moratorium and is not being applied in British Columbia, Ontario, Nova Scotia and Saskatchewan. This moratorium is expected to last until December 31, 2008. Section 2.4.1 would not be adopted while the moratorium is in effect.

Rule 3 setting forth *financial and operations requirements* and Rule 5, covering record keeping (other than sections 5.5 and 5.6) would be adopted. However, Rule 4, which covers *insurance requirements*, would not be adopted because it is incompatible with the liability insurance regime provided for in Québec.

3.3 Mutual fund representatives registered in Québec would continue to be members of the CSF and pay the mandatory annual contribution.

The status, organizational structure and functions of the CSF under the Distribution Act would not be amended. Mutual fund representatives¹² would therefore be required to be members of the CSF, which would apply MFDA rules as they relate to oversight of ethics and discipline.

Mutual fund representatives consequently would be subject to:

- a. Payment of the annual contribution to the CSF as determined by regulation
- b. The jurisdiction of the CSF discipline committee, and
- c. The requirements of the CSF for mandatory professional development.

3.4 The regime for mandatory annual FSCF contributions paid by mutual fund firms based on number of representatives would not be amended for mutual fund firms registered in Québec.

The AMF is not recommending any change to the requirement that Québec mutual fund firms and representatives contribute to the FSCF.

¹⁰ On-line at <http://www.lautorite.qc.ca/userfiles/File/bulletin-publications/Guide-anglais-2005.pdf>.

¹¹ Excluding i) subparagraph c) of section 1.2.1, which refers to a training program, since CSF mandatory ongoing development requirements would continue to apply to registered representatives in Québec who have their main offices there, and ii) subparagraph d) vii) of section 1.2.1, which relates to financial planning.

¹² As well as scholarship plan and investment contract representatives, other than representatives registered in Québec who do not have their main offices located there (see section 2, *AMF Recommendations, Passport registration System*).

3.5 The liability insurance regime for mutual fund firms and representatives registered in Québec would not be changed.

In its first proposal document, the AMF proposed that Québec mutual fund dealers be required to maintain a financial institution bond for coverage against dishonest conduct or fraud by representatives and against loss of securities and forgery.

The current liability insurance requirements, whereby Québec mutual fund firms and their representatives must hold liability insurance, are intended to protect them against errors and omissions.¹³ This requirement would continue to be applicable to mutual fund dealers and their representatives,¹⁴ who would not be required to maintain a financial institution bond.

3.6 Annual fees for maintaining registration would be amended.

The AMF received several comments about fees and the financial burden imposed on firms and representatives, and has been cautioned about potentially excessive costs should the law be amended and an industry SRO recognized in Québec. The AMF has taken these comments into account and its recommendation follows.

Fees payable upon registration

The AMF is not recommending any change to the current registration fee schedule under the Distribution Act regime:

- \$80 per representative, payable by the firm for its registration
- \$80 payable by the representative

And in addition to these fees:

- FSCF contributions, payable by the firm based on the number of representatives
- CSF membership fees, payable by representatives

Fees payable annually for maintaining registration

Fees payable annually to the AMF for maintaining registration of all Québec mutual fund dealers, whether or not they are MFDA members, would be \$80 per representative, to which would be added the following:

- 0.0013% of the first \$500 million of assets under administration in Québec, and 0.0011% of assets over \$500 million
- FSCF contributions, payable by the firm and its representatives
- CSF membership fees

Appendix A shows current fees and how the proposed schedule would be applied, with examples of hypothetical firms.

¹³ For firms, this requirement is specified in section 29 of the *Regulation respecting firms, independent representatives and independent partnerships*.

¹⁴ With the exception, however, of representatives registered in Québec who do not have their main offices there (see section 2, *AMF Recommendations, Passport registration System*).

APPENDIX A TO SECOND PROPOSAL DOCUMENT
RELATING TO THE REGULATORY FRAMEWORK
APPLICABLE TO THE MUTUAL FUND SECTOR
FURTHER TO THE REGISTRATION REFORM PROJECT, SEPTEMBER 21, 2007

PROPOSED FEE SCHEDULE

1) Summary of current fee schedule

	Registration	CSF	Annual Fees
Firms	\$80 per representative	—	\$80 per representative
Representatives	\$80	\$238 ¹⁵	\$80

2) Examples of current registration fees for maintaining registration

The following table shows how current fees¹⁶ apply to four firms under various scenarios. Certification renewal fees for representatives are not included in totals for firms because representatives are responsible for paying these fees. The scenarios assume that firms pay their own fees and those due to the CSF.

Scenario	CSF for representatives	Annual fees	Total
Firm A: 2 representatives ¹⁷	\$476	\$160	\$636
Firm B: 50 representatives	\$11,900	\$4,000	\$15,900
Firm C: 600 representatives	\$142,800	\$48,000	\$190,800
Firm D: 1,000 representatives	\$238,000	\$80,000	\$318,000

3) Scenarios for proposed registration fees for maintaining registration

At the time of registration: Fees payable to the AMF by firms and representatives at the time of registration would be the same as current fees under the Distribution Act. Representatives would remain responsible for paying CSF contributions.

¹⁵This amount includes applicable taxes.

¹⁶This table does not take into consideration fees payable to the CSF for professional development units.

¹⁷For purposes of tables presented in the appendix, all representatives are presumed to have only mutual fund activities.

Annual fees for maintaining registration: Annual fees for maintaining registration of mutual fund dealers registered in Québec, whether or not they are MFDA members, would be \$80 per representative plus an additional fee based on the amount of assets the firm has under administration of the firm in Québec, as shown below.

Assets under administration (AUA): Market value of all securities held by mutual funds in client accounts in Québec (in street or client names).¹⁸ The amount of assets under administration is calculated at the time of filing of the *Financial Questionnaire and Report (FQR)*, which is prescribed by the MFDA and would be adopted by the AMF.

Fee schedule: The fee schedule for assets under administration in Québec would be 0.0013% of the first \$500 million and 0.0011% of assets over \$500 million.

4) Examples of proposed fees for maintaining registration

The following table shows how proposed fees apply to the same four hypothetical firms.

Scenario	CSF for representatives	Fixed annual fees	Annual fees based on AUA	Total	Increase compared with current fees
Firm A: 2 representatives ¹⁹ and \$175 million in AUA	\$476	\$160	\$2,275	\$2,911	\$2,275
Firm B: 50 representatives and \$400 million in AUA	\$11,900	\$4,000	\$5,200	\$21,100	\$5,200
Firm C: 600 representatives and \$1 billion in AUA	\$142,800	\$48,000	\$6,500 on 1st \$500M \$5,500 on balance	\$202,800	\$12,000
Firm D: 1,000 representatives and \$3.5 billion in AUA	\$238,000	\$80,000	\$6,500 on 1st \$500M \$33,000 on balance	\$357,500	\$39,500

¹⁸In accordance with the *Notes and Instructions* of FQR Schedule B.

¹⁹For purposes of this table, all representatives are presumed to have only mutual fund activities.