

13.1.3 Summary of Public Comments Respecting Proposed Amendments to Section 35 (No Actions Against the Corporation) of MFDA By-law No. 1 and Responses of the MFDA

On June 26, 2009, the British Columbia Securities Commission and Ontario Securities Commission published proposed amendments to section 35 (No Actions Against the Corporation) (the “**Proposed Amendments**”) for a 90-day public comment period.

The public comment period expired on September 24, 2009.

4 submissions were received during the public comment period:

1. Independent Financial Brokers of Canada (“IFB”)
2. Investment Funds Institute of Canada (“IFIC”)
3. Portfolio Strategies Corporation (“PSC”)
4. Royal Mutual Funds Inc. (“RMFI”) and Phillips, Hager & North Investment Funds Ltd. (“PH&N”)

Copies of comment submissions may be viewed at the offices of the MFDA, 121 King Street West, Suite 1000, Toronto, Ontario by contacting Ken Woodard, Director, Communications and Membership Services, (416) 943-4602.

The following is a summary of the comments received, together with the MFDA's responses.

Objectives of Proposed Amendments

RMFI and PH&N and IFIC agreed with the principle that the MFDA Investor Protection Corporation (“MFDA IPC”) and its directors, officers and personnel should be provided protection against legal actions and proceedings in the discharge of their investor protection and risk management mandates.

Citing the MFDA statement that the Proposed Amendments are intended to “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”, the IFB questioned whether the MFDA or MFDA IPC should have such broad protection from a potential legal action by a Member or Approved Person. The IFB expressed the view that the ability exercise the right to legal recourse, where no other satisfactory resolution can be arrived at, is a fundamental principle of our legal system. The IFB expressed the opinion that, while such instances may arise infrequently, the ability to pursue legal action would not reduce the consumer protection mandate of the MFDA IPC Board or the MFDA Board. The IFB noted that MFDA and MFDA IPC officers, employees and directors have errors and omissions insurance coverage to protect them from personal liability where such instances arise and are found to have merit and expressed the view that removing the right of those regulated by the MFDA to commence a legal challenge seems unnecessarily protective, irrespective of whether a similar provision exists for Investment Industry Regulatory Organization of Canada (“IIROC”) and Canadian Investor Protection Fund (“CIPF”) directors.

The IFB expressed the view that those regulated by the MFDA should have the ability to challenge a decision of the MFDA or MFDA IPC and noted that, while such situations will be infrequent, similarly to shareholders who may institute a “derivative action” against directors who do wrong against the corporation, so should MFDA stakeholders, such as Approved Persons.

MFDA Response

The Proposed Amendments are intended to extend the protections of section 35 of MFDA By-law No. 1, currently available to MFDA Board of Directors, committee members, officers, employees and agents, to the corresponding persons and bodies of the MFDA IPC, so that actions of the MFDA IPC, similarly to those of the MFDA, are not constrained by a threat of legal action in exercising its regulatory mandate in the public interest.

We disagree with the proposition that the ability to pursue legal action would not reduce the consumer protection mandate of the MFDA IPC Board or the MFDA Board. In order to properly discharge their investor protection mandate, both MFDA and MFDA IPC directors, officers and employees must be adequately protected from legal actions by MFDA Members, Approved Persons or other persons under the jurisdiction of the MFDA. Since the MFDA is a regulator and a non-for-profit corporation and its mandate differs from that of a corporation intended for profit, it would be inappropriate for MFDA Members to be entitled to any equivalent to shareholders' derivative action.

MFDA IPC Fee Assessment Methodology

PSC expressed disappointment that the MFDA and the MFDA IPC did not address the MFDA IPC fee assessment methodology, under which fees are assessed against all MFDA Members regardless whether they operate in client name or nominee name, in spite of the fact that the MFDA IPC only covers nominee name accounts. PSC expressed the view that this

results in Members operating in nominee name receiving a subsidy from Members operating client name accounts and expressed the view that, since it is estimated that more than 80% of assets at Members are in client name, the subsidy for the riskier nominee name accounts is substantial. PSC recommended that the MFDA IPC commit to a transparent consultation process, open to all Members, regarding eliminating the unjustified subsidy of riskier nominee name business.

RMFI and PH&N expressed the view that the current MFDA IPC assessment methodology is inequitable and recommended that the MFDA IPC contributions take into account the inherent risks of each Member and that the MFDA and MFDA IPC ensure that the overall investor protection fund and insurance costs are kept under control and are based on a reasonable measure of perceived risk to clients' assets.

MFDA Response

The scope of the Proposed Amendments is limited to extending the protection available to MFDA directors, officers and personnel to the individuals performing the same functions at the MFDA IPC and providing for the terms of the relationship between the MFDA and MFDA IPC and existing MFDA and Member obligations to the MFDA IPC.

The MFDA IPC is aware of concerns with respect to the MFDA IPC fee assessment methodology, as discussed at length during the MFDA IPC working group meetings. When this issue is revisited in the future, it will be subject to the MFDA public consultation process.

Consolidate MFDA IPC Requirements

RMFI and PH&N recommended defining and formalizing, in one place, Member obligations to the MFDA IPC, as IIROC recently did in relation to the CIPF in its IIROC Dealer Member Rule 41.

MFDA Response

The MFDA will consider this suggestion for future Rule amendments.

Comparison with IIROC Provisions

The IFB noted that the equivalent section in the IIROC By-Law, Article 14, section 14.1, *No Actions Against the Corporation* seems to have more broadly worded exemptions than the MFDA version and recommended that, if the sections are intended to be comparable between the MFDA and IIROC, then this broader wording be included in the Proposed Amendments.

MFDA Response

The structure of the IIROC and MFDA By-laws and Rules is somewhat different and, accordingly, the wording of proposed MFDA section 35 of By-law No. 1 and IIROC section 14 of its By-law No. 1 are slightly different. However, the scope of the protection under both By-laws is substantially the same and achieves the same regulatory result.

Ability of Approved Persons to Undertake Legal Action

The IFB specifically questioned the inclusion of Approved Persons in those not permitted to take legal action under the Proposed Amendments and expressed the view that Approved Persons do not share the same standing with the MFDA or MFDA IPC as Members, as they do not participate in the governance of either corporation, have no direct representation on the Boards, nor the right to vote on matters related to their mutual fund business or to choose directors. The IFB expressed the view that, for this reason, Approved Persons should be able to undertake a legal action, in the unlikely event that such a situation arises.

MFDA Response

The Proposed Amendments will provide protection to the MFDA IPC, its directors, officers and personnel in a manner similar to that already available to the MFDA and the specified persons and bodies under section 35 of By-law No. 1. As noted above, such protection is necessary so that the specified individuals are able to adequately discharge their regulatory mandate. In order to provide adequate protection to the MFDA IPC and its directors, officers, employees and agents, Approved Persons should not be excluded from the list of individuals not permitted to undertake a legal action. It is noted that the protection of CIPF afforded by section 14 of the IIROC By-law refers to Regulated Persons which would include the corresponding class of Approved Persons under the MFDA By-law.

Requirement to Pay Assessments Levied by MFDA IPC

Referring to the proposed requirement under section 35A that Members "promptly pay to the MFDA all regular and special assessments levied or prescribed by the IPC...", IFIC requested clarification as to what would ensure equitable allocation and a fair and reasonable process of levying such assessments. IFIC expressed concern with respect to lack of any checks on the MFDA IPC Board, including costs, and requested clarification as to what extent the MFDA and MFDA IPC Boards consult their membership on these matters.

IFIC expressed the view that the Proposed Amendments do not provide its Members with sufficient information about the MFDA IPC fee levying process to permit them to analyze the effects that the Proposed Amendments may have on their businesses. IFIC recommended that the MFDA IPC establish a funding formula that explicitly states how special assessments will be made and allocated and that the MFDA ensure that the process in which special assessments are levied is transparent and follows the same funding formula.

RMFI and PH&N requested confirmation that regular and special assessments prescribed by the MFDA IPC in respect of Members will be fair and equitable.

MFDA Response

The Recognition Orders of the Recognizing Jurisdictions require that the MFDA cooperate with the MFDA IPC as a compensation fund approved by the Recognizing Jurisdictions. Pursuant to the Recognition Orders, MFDA By-law No. 1 provides for the authority of MFDA to assess its Members and require payment of such assessments in respect of the MFDA IPC as a compensation fund. Any changes to regular and special assessments prescribed or levied by the MFDA IPC have to be approved by the MFDA Board of Directors.

MFDA IPC Review of Members

With respect to section 35A.2(d) of the Proposed Amendments, which requires Members to permit MFDA IPC reviews of Members RMFI and PH&N recommended that, in order to maintain efficiency of regulatory oversight, information required by the MFDA IPC be added to the scope of examinations conducted by MFDA staff.

MFDA Response

The MFDA IPC generally relies on the regulatory efforts of the MFDA. Current MFDA examinations provide all information required by the MFDA IPC in a normal course of action. The MFDA IPC would conduct additional activities only in special circumstances, if it deems it necessary as part of its regulatory mandate.