

13.1.2 Proposed New MFDA Rule 2.4.4 (Transaction Fees or Charges) and Proposed Amendments to MFDA Rule 5.1 (Requirement for Records)

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

PROPOSED NEW MFDA RULE 2.4.4 (TRANSACTION FEES OR CHARGES)

AND

PROPOSED AMENDMENTS TO MFDA RULE 5.1 (REQUIREMENT FOR RECORDS)

I. OVERVIEW

A. Current Rules

MFDA Rule 5.4.3 requires that trade confirmations include information about commissions, sales, service or other charges and deferred sales charges applied/deducted in respect of the trade. Trade confirmations are issued to clients *after* the transaction is executed. Although considered industry best practice, there is currently no express requirement under MFDA Rules to inform clients *at the time* of a transaction of fees and charges that will be incurred by the client and deducted from client funds as a result of the transaction.

B. The Issues

The MFDA has received a significant number of complaints where clients have advised staff that they were not informed of the fees and charges resulting from a particular transaction prior to the acceptance of their order and only became aware of such information when they received their trade confirmation or account statement. To make informed decisions, clients require information in respect of transaction fees and charges prior to the acceptance of their order.

C. Objectives

The objective of the proposed amendments is to assist investors in making decisions with respect to transactions in their account by requiring Members to inform investors of transaction fees or charges prior to the acceptance of their order.

D. Effect of Proposed Amendments

The effect of the proposed amendments will be to require, at the time of a transaction, that clients be informed of fees or charges that will be incurred by them and deducted in respect of the transaction.

II. DETAILED ANALYSIS

A. Proposed New Rule 2.4.4 and Proposed Amendments to Rules 5.1(b)

MFDA Rules would be amended to include new Rule 2.4.4, which would require that, prior to the acceptance of an order, the Member inform the client of any sales charge, service charge or any other fees or charges to be deducted in respect of the transaction. As noted, clients require such information prior to the acceptance of their order to be able to make informed decisions. Proposed new Rule 2.4.4 addresses direct transaction fees and charges and is not intended to capture indirect fees or charges, such as Management Expense Ratios or trailing commissions, as such fees and charges are being considered by the CSA as part of proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* and related amendments, published for comment by the CSA on June 19, 2009 for a 120 day comment period (CSA Point of Sale initiative). For example, the proposed amendments would require that clients be informed of redemption, switch or transfer fees. Conforming changes would be made to Rule 5.1(b) by adding subsection (iv), which would require Members to maintain records evidencing that the client was informed of all fees and charges in accordance with Rule 2.4.4.

For the purpose of complying with the proposed Rule amendments, Members may use the current methods that they employ to evidence client instructions, for example maintaining detailed notes to file, taping telephone conversations or by maintaining copies of client acknowledgements prior to the acceptance of the client order.

B. Issues and Alternatives Considered

The proposed amendments were brought forward by staff for consideration by the MFDA Policy Advisory Committee ("PAC"). In their consideration of proposed new Rule 2.4.4, several PAC members commented that Approved Persons may not have exact information with respect to short-term trading fees that are applied by the fund companies. Disclosure of the exact amount of such fees could be difficult as complex calculations may be required, in addition to the fact that such fees are levied at the

discretion of the fund company. In response, staff clarified that where specific information in respect of transaction fees or charges is not available at the time of the transaction the Member would be expected to provide as much accurate and detailed information as is available at the time to give the client a reasonable idea of transaction fees and charges that will apply.

In developing the proposed amendments, staff considered proposed requirements with respect to disclosure of fees and charges contemplated under the proposed CSA Point of Sale initiative.

Disclosure of fees and charges under the Point of Sale initiative is product specific and would be provided to the client (by way of the Fund Facts document) on a purchase. However, the CSA Point of Sale initiative does not contemplate the provision of such disclosure on a redemption. We note that one of the major reasons prompting the development of the proposed amendments was the disclosure of deferred sales charges at the time of the transaction. The disclosure required under the proposed amendments is, accordingly, more specific, in respect of direct transaction fees and charges and would be required at the time of the transaction (i.e. prior to the acceptance of the client order).

C. Comparison with Similar Provisions

United Kingdom

Section 6.4.3 of the Financial Services Authority ("FSA") Conduct of Business Sourcebook ("COBS") sets out requirements for the disclosure of charges, remuneration and commissions for packaged products, which includes units of Collective Investment Schemes ("CIS"):

(1) If a firm sells, personally recommends or arranges the sale of a packaged product to a retail client, and subsequently if the retail client requests it, the firm must disclose to the client in cash terms:

- (a) any commission receivable by it or any of its associates in connection with the transaction;
- (b) if the firm is also the product provider, any commission or commission equivalent payable in connection with the transaction; and
- (c) if the firm or any of its associates is in the same immediate group as the product provider, any commission equivalent in connection with the transaction.

(2) Disclosure "in cash terms" in relation to commission does not include the value of any indirect benefits listed in the table at COBS 2.3.15 G.

(3) In determining the amount to be disclosed as commission equivalent, a firm must put a proper value on the cash payments, benefits and services provided to its representatives in connection with the transaction.

(4) This rule does not apply if:

- (a) the firm is acting as an investment manager; or
- (b) the retail client is not present in the EEA at the time of the transaction; or
- (c) the firm provides the client with a key features document or a simplified prospectus, in accordance with COBS 14, provided that the firm discloses to the client the actual amount or value of commission or equivalent within five business days of effecting the transaction.

(5) If the terms of a packaged product are varied in a way that results in a material increase in commission or commission equivalent, a firm must disclose to a retail client in writing any consequent increase in commission or equivalent receivable by it in relation to that transaction.

Point of Sale Disclosure for Mutual Funds

As noted above, in developing the proposed amendments consideration was given to disclosure required under the CSA's Point of Sale initiative which would require that the Fund Facts Document be provided to the client on a purchase but not at the time of redemption. One of the main reasons for the introduction of proposed new Rule 2.4.4 is to ensure that redemption fees and charges are properly disclosed to clients prior to the acceptance of their redemption order.

MFDA CRM Proposal

Existing and proposed new MFDA Rules require general disclosure of compensation and service fees and charges at the time of account opening.

On May 8, 2009, proposed amendments to MFDA Rule 2.2, Policy No. 2, Rules 2.8.3 and 5.3 (Client Relationship Model Proposal) were published for public comment. These amendments included proposed new Rule 2.2.5 (Relationship Disclosure) which requires, for each new account opened, that the Member provide written disclosure to the client describing the nature of the compensation that may be paid to the Member and refer the client to other sources for more specific information. In addition, current MFDA Rule 2.4.3 (Service Fees or Charges) requires that Members provide clients with disclosure of service fees and charges on account opening. The more specific disclosure required at the time of the transaction in respect of fees and charges under proposed new Rule 2.4.4 would work in conjunction with and complement the general disclosure required at the time of account opening under Rule 2.4.3 and as proposed under new Rule 2.2.5.

D. Systems Impact of Amendments

As noted, the proposed amendments are consistent with industry best practice and, as a result, it is not anticipated that they will result in a significant systems impact to Members.

E. Best Interests of the Capital Markets

The Board has determined that the proposed amendments are in the best interests of the capital markets.

F. Public Interest Objective

The proposed amendments are in the public interest, respond to regulatory concerns identified by staff and will assist investors in making decisions with respect to transactions in their account by requiring Members to inform investors of transaction fees and charges prior to the acceptance of their order.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments have been prepared in consultation with relevant departments within the MFDA and have been reviewed by the Policy Advisory Committee of the MFDA and the Regulatory Issues Committee of the Board. The MFDA Board of Directors approved the proposed amendments on June 3, 2010.

D. Effective Date

The proposed amendments will be effective on a date to be subsequently determined by the MFDA.

IV. SOURCES

Section 6.4.3 of the Conduct of Business Sourcebook of the Financial Services Authority
MFDA Rules 2.2, 2.8.3, 5.3 and MFDA Policy No. 2
MFDA Rule 5.1
Proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

V. REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issues referred to above may be considered by the Recognizing Regulators.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered by **September 23, 2010** (within 90 days of the publication of this notice) addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of Julianna Paik, Senior Legal Counsel, British Columbia Securities Commission, 701 West Georgia Street, P.O. Box 10142, Pacific Centre, Vancouver, British Columbia, V7Y 1L2.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at www.mfda.ca.

Questions may be referred to:

Paige Ward
Director, Policy and Regulatory Affairs
Mutual Fund Dealers Association of Canada
(416) 943-5838

SCHEDULE "A"

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

TRANSACTION FEES OR CHARGES AND REQUIREMENT FOR RECORDS

(Proposed New Rule 2.4.4 and Proposed Amendments to Rule 5.1)

On June 3, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following new Rule 2.4.4 and amendments to Rule 5.1:

New Rule 2.4.4 (Transaction Fees or Charges)

2.4.4 Transaction Fees or Charges. Prior to the acceptance of any order in respect of a transaction in a client account, the Member shall inform the client of any sales charge, service charge or any other fees or charges to be deducted in respect of the transaction.

New Subsection 5.1(b)(iv)

5.1 REQUIREMENT FOR RECORDS

Every Member shall keep such books, records and other documents as are necessary for the proper recording of its business transactions and financial affairs and the transactions that it executes on behalf of others and shall keep such other books, records and documents as may be otherwise required by the Corporation. Such books and records shall contain as a minimum the following:

- (b) an adequate record of each order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such record shall show:
 - (i) the terms and conditions of the order or instructions and of any modification or cancellation thereof;
 - (ii) the account for which entered or received; and
 - (iii) the time of entry or receipt, the price at which executed and, to the extent feasible, the time of execution or cancellation; and
 - (iv) evidence that the client was informed of all fees and charges in accordance with Rule 2.4.4