

13.1.3 Joint Notice and Request for Comment of Certain Recognizing Regulators of the Mutual Fund Dealers Association of Canada – Application to Amend Recognition Orders

**JOINT NOTICE AND REQUEST FOR COMMENT OF CERTAIN RECOGNIZING REGULATORS
OF THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA –
APPLICATION TO AMEND RECOGNITION ORDERS**

The Mutual Fund Dealers Association of Canada (the MFDA) has submitted an application to the securities regulatory authority in each of British Columbia, Ontario, Saskatchewan, and Nova Scotia (the Applicable Jurisdictions) to amend the orders of each of the Applicable Jurisdictions recognizing the MFDA as a self-regulatory organization (the Recognition Orders). The MFDA requested the amendments in order to extend the suspension of MFDA Rule 2.4.1, which currently expires on December 31, 2008, to December 31, 2010.

The Applicable Jurisdictions are publishing for comment the MFDA's application and related documents, all of which you can find on the Applicable Jurisdictions' websites or in their bulletins, where applicable.

We are seeking comments on all aspects of the application and related documents.

A. PURPOSE FOR PROPOSED CHANGE TO THE RECOGNITION ORDERS

Rule 2.4.1 requires MFDA Members to pay any remuneration for business conducted by MFDA Approved Persons on the Members' behalf directly to and in the name of the Approved Persons. The MFDA is requesting that the Applicable Jurisdictions extend the suspension of the rule to give it time to develop proposed amendments that would allow Approved Persons to direct remuneration in respect of business they conduct on behalf of MFDA Members to non-registered corporations, subject to certain conditions.

B. PREVIOUS EXTENSIONS OF THE SUSPENSION OF MFDA RULE 2.4.1

The Applicable Jurisdictions have previously extended the suspension of Rule 2.4.1.

These extensions were granted on the understanding and condition that Approved Persons are conducting all activities requiring registration on behalf of and through the facilities of MFDA Members, as employees or agents of those Members, and not on behalf of or through the non-registered corporation (i.e. not as an employee or agent of the non-registered corporation), regardless of whether they direct the Members to pay their remuneration for those activities to the non-registered corporation.

C. CURRENT APPLICATION TO EXTEND THE SUSPENSION OF MFDA RULE 2.4.1

The MFDA has requested an extension of the suspension of Rule 2.4.1 until December 31, 2010.

Staff of the Ontario Securities Commission, the Nova Scotia Securities Commission and the Saskatchewan Financial Services Commission will consider an extension of the suspension until March 31, 2010, with a requirement for the MFDA to submit its proposed amendments to Rule 2.4.1 by May 31, 2009. These staff are of the view that a March 31, 2010 expiry date would provide sufficient time to consider the regulatory impact of proposed amendments to MFDA Rule 2.4.1.

OSC, NSSC and SFSC staff do not support any further extensions. An expiry date of March 31, 2010 would provide sufficient time for MFDA Members and Approved Persons to restructure any commission direction arrangements, to ensure compliance with Rule 2.4.1, should the MFDA not submit a proposal by May 31, 2009.

BCSC staff is of the view that an extension is necessary to allow the MFDA time to develop amendments to Rule 2.4.1. However, BCSC staff is not taking a position on the appropriate length of the extension or future extensions at this time. In addition to commenting on matters relating to the substance of the application to extend the suspension of Rule 2.4.1, BC staff asks that you also comment on the appropriate date for the submission of the rule amendments and the expiry of the suspension.

D. COMMENT PROCESS

We ask you to provide your comments in writing and to send them on or before September 29, 2008, to:

c/o Sarah Corrigan-Brown
British Columbia Securities Commission
701 West Georgia Street
Vancouver, BC V7Y 1L2

Email: scorrigan-brown@bcsc.bc.ca

SRO Notices and Disciplinary Proceedings

We cannot keep submissions confidential. We will publish a summary of written comments we receive during the comment period.

If you have questions about this notice, you may contact:

Sarah Corrigan-Brown
British Columbia Securities Commission
(604) 899-6738

Curtis Brezinski
Saskatchewan Financial Services Commission
(306) 787-5876

Jonathan Sylvestre
Ontario Securities Commission
(416) 593-2378

Shirley Lee
Nova Scotia Securities Commission
(902) 424-5441

If you have any questions about the MFDA's application, you may contact any of the people listed above, or you may contact:

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

August 29, 2008

July 16, 2008

Executive Director
British Columbia Securities Commission
P.O. Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, B.C.
V7Y 1L2

The Secretary to the Commission
Ontario Securities Commission
20 Queen Street West
Suite 1900, P.O. Box 55
Toronto, Ontario
M4S 3S8

The Secretary to the Commission
Saskatchewan Financial Services Commission
1919 Saskatchewan Drive
6th Floor
Regina, Saskatchewan
S4P 3V7

The Secretary to the Commission
Nova Scotia Securities Commission
2nd Floor, Joseph Howe Building
P.O. Box 468
1690 Hollis Street
Halifax, Nova Scotia
B3J J39

Dear Sirs/Mesdames:

**Re: Mutual Fund Dealers Association of Canada
Application for amendment and restatement of terms and
conditions of order recognizing self-regulatory organization**

1. APPLICATION

(a) Summary

This application is made by the Mutual Fund Dealers Association of Canada ("MFDA") concurrently to each of the British Columbia Securities Commission, the Ontario Securities Commission, the Saskatchewan Financial Services Commission and the Nova Scotia Securities Commission (respectively, the "BCSC", "OSC", "SFSC" and "NSSC" and, together, the "Commissions") for an amendment and restatement of the terms and conditions of the Order of each such Commission recognizing the MFDA as a self-regulatory organization ("SRO") pursuant to section 24(a) of the *Securities Act* (British Columbia), section 21.1(1) of the *Securities Act* (Ontario), section 21(2) of the *Securities Act, 1998* (Saskatchewan) and section 30(1) of the *Securities Act* (Nova Scotia), (respectively, the "OSA", "BCSA", "SSA" and "NSSA" and together, the "Legislation"). In 2004, the BCSC, OSC, SFSC and NSSC approved an application by the MFDA to amend and restate its Orders in respect of recognition of the MFDA. The date of the amended and restated Orders in respect of recognition of the MFDA referred to above by each of the BCSC, OSC, SFSC and NSSC are, respectively, June 3, 2004, March 30, 2004, April 16, 2004, and April 8, 2004. Further variation orders amending s. 14 of Schedule "A" to the Orders were made by the BCSC, OSC, SFSC and NSSC on November 17, 2006, November 17, 2006, November 9, 2006 and November 8, 2006, respectively. The Orders of the respective Commissions recognizing the MFDA as an SRO are referred to individually and collectively in this application as an "Order" or the "Orders" and the terms and conditions attached as Schedule A to each such order are referred to individually and collectively as "Terms and Conditions".

(b) Authority for Application

This application is made to the respective Commissions pursuant to Section 171 of the BCSA, Section 144 of the OSA, Section 158(3) of the SSA and Section 151 of the NSSA.

(c) Terms and Conditions to be Amended

The Term and Condition of the BCSC, OSC, SFSC and NSSC Orders to be amended is Section 14 (Suspension of MFDA Rule 2.4.1).

2. THE APPLICANT

The MFDA is a non-share capital corporation under Part II of the *Canada Corporations Act* incorporated on June 19, 1998 and has been recognized as an SRO pursuant to the Orders of the Commissions referred to in paragraph 1 of this Application.

3. BASIS OF APPLICATION

Section 14 of the Terms and Conditions provides for the suspension of MFDA Rule 2.4.1 (the "Rule") relating to the payment of remuneration in respect of Approved Persons by Members of the MFDA in the Provinces of British Columbia, Saskatchewan, Ontario and Nova Scotia. The suspension of the Rule, originally to expire on December 31, 2004 has been extended by the Commissions to December 31, 2008. The MFDA is requesting that the suspension period for the Rule be extended until December 31, 2010. The extension is being requested to allow the MFDA time to develop proposed amendments to Rule 2.4.1 that will allow Approved Persons to direct remuneration in respect of business conducted by them on behalf of a Member to a non-registered corporation, subject to conditions.

Over the course of the suspension period for the Rule, the MFDA has had the opportunity to review the effect of the suspension on the application of other MFDA Rules and its potential effect on other investor protection issues. MFDA staff estimates that of the approximately 75,000 registered Approved Persons, approximately 35,000 are those of bank-owned Members that do not rely on the suspension of the Rule and that a high proportion of the approximately 40,000 Approved Persons that remain are likely to rely on its suspension. Despite these large numbers and the fact that the suspension has been in place for several years, the MFDA has not experienced any effect on the regulatory liability of Approved Persons arising from the payment of commissions to corporations and is unaware of any changes in the industry that might increase the risk of negative impacts since the last suspension was granted. In addition, the payment of commissions to non-registered corporations is a long-standing business practice that predates the establishment of the MFDA and concerns have been expressed that it would be disruptive to industry to disallow it. Based on this information, the MFDA is satisfied that the arrangements currently in place do not raise investor protection concerns and that allowing them to continue would not be contrary to the public interest.

MFDA Rule 1.1 provides that, in general, no Member or Approved Person may, directly or indirectly, engage in any securities related business unless it is carried on for the account of the Member, through its facilities and in accordance with the By-laws and Rules. Each Approved Person who conducts or participates in any securities related business in respect of a Member must comply with the By-laws and Rules as they relate to the Member or such Approved Person.

Rule 1.1.4 and Rule 1.1.5 set out the required terms for the Member/Approved Person employment or agency relationships permitted under the MFDA Rules, including the Member's obligation to supervise the activity of the Approved Person and the Approved Person's responsibility to comply with MFDA requirements and conduct business through the Member. Rule 1.2.1(d) sets out a number of limitations on non-securities related business that Approved Persons may conduct outside the Member and disclosure requirements where Approved Persons engage in such activity. MFDA Member Regulation Notice MR-0002 sets out the conditions for reliance on relief from Rule 2.4.1. The sample form agreement contained in Schedule "A" to MR-0002 (or an equivalent agreement) must be executed by any Approved Person that seeks to rely on the relief from Rule 2.4.1. This agreement provides for access by regulators, the MFDA and the Member to books and records of the corporation to which commissions have been directed and requires the corporation to cooperate in the event of any review for compliance with regulatory requirements.

The Rules noted above have been implemented to ensure that all securities related business conducted by Members and Approved Persons is done through the Member firm and in accordance with MFDA By-laws and Rules. The MFDA is of the view that the requirements and regulatory oversight built into Rule 1 address any concerns that might arise in connection with registrants somehow escaping regulatory liability by directing commissions to non-registered corporations. The MFDA is satisfied that the existing provisions properly address the issue as it has not faced challenges to its jurisdiction and there are no cases where clients have been at risk based on the entity to which commissions are paid.

In each compliance review that is completed, MFDA staff test to ensure that Members and Approved Persons comply with the requirements of all MFDA By-laws, Rules and Policies through a variety of interviews and substantive testing methods. Along with other requirements, MFDA staff looks at compliance with Rule 1.1.1 in all compliance reviews regardless of the relationship between the Member and the Approved Person (e.g. employer/employee or principal/agent) or how the Approved Person receives commissions. Where Approved Persons rely on the suspension of Rule 2.4.1, staff test to ensure that the requirements set out in Member Regulation Notice MR-0002 have been satisfied and that contracts are in place allowing access to MFDA and commission staff to the corporate books and records of all entities to which commissions have been directed.

As noted, the MFDA historically has not observed issues related to the avoidance of regulatory or civil liability for securities related activities or other issues resulting from the suspension of the Rule. On occasion, MFDA staff does detect evidence that Approved Persons have conducted registerable activities through an unlicensed corporation outside of the Member. Approved Persons engaging in such conduct, irrespective of whether they do so as individuals or through a personal corporation, are acting in contravention of Rule 1 and any such instances that are discovered during compliance reviews are referred to Enforcement for appropriate action. In any case where an Approved Person fails to provide access to books and records (corporate or personal), the MFDA considers such refusal to be a failure to cooperate and enforcement action is taken in all instances where Approved Persons fail to provide access to such records.

The MFDA is aware that commission payment structures employed by Members and Approved Persons have been permitted by tax authorities in some cases and disallowed in others. The outcomes of each particular tax ruling appear to be extremely fact specific. On the basis that the history of such arrangements does not show a significant risk to Member solvency, the MFDA does not believe the potential for negative tax rulings poses any great significance from an investor protection perspective. Negative tax rulings would, in any event, be addressed in a manner similar to any other negative ruling under the requirements of applicable legislation. Similar to any other lawsuit/potential financial liability that a Member might face, the MFDA would require the Member to record information in respect of any negative tax ruling on the Member's Financial Questionnaire and Report ("FQR") as a contingent liability.

The MFDA does not monitor Member or Approved Person compliance with tax legislation and this position is consistent for both Approved Persons that receive their commissions directly and those that have commissions directed to corporations. As compliance with tax legislation is subject to independent regulatory oversight, the MFDA is of the view that it is unnecessary to exercise jurisdiction in this area and has not, to date, seen the need to implement tax compliance requirements in the existing principal-agent rule.

(a) Supporting Documentation

Submitted with this application are the following supporting documents in original or photocopied form:

- (i) a draft order amending and restating the Terms and Conditions of the Order on the basis described herein; and
- (ii) draft revised Terms and Conditions contained in Schedule A to the Orders reflecting the amendments described herein.

This application has been reviewed and approved by, and is signed and made by, duly authorized officers of the MFDA and such officers confirm the truth of the facts contained herein. In addition to the undersigned officers, representatives of MFDA counsel, Borden Ladner Gervais LLP, are authorized to discuss this application and any matter related to it with the Commissions.

Yours very truly,

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

By: "Larry Waite"
President and Chief Executive Officer

By: "Mark T. Gordon"
Executive Vice-President

IN THE MATTER OF
THE SECURITIES ACT, R.S.O 1990, CHAPTER S.5,
AS AMENDED (the "Act")

AND

IN THE MATTER OF
MUTUAL FUND DEALERS ASSOCIATION OF CANADA/
ASSOCIATION CANADIENNE DES COURTIERES DE FONDS MUTUELS
(THE "MFDA")

AMENDMENT AND RESTATEMENT
OF RECOGNITION ORDER
(Section 144)

WHEREAS the Commission issued an order dated February 6, 2001, recognizing the MFDA as a self-regulatory organization for mutual fund dealers pursuant to section 21.1 of the Act ("Original Order");

AND WHEREAS the Commission issued an order dated March 30, 2004, amending and restating the terms and conditions of the Original Order;

AND WHEREAS the Commission issued an order dated November 3, 2006, varying the terms and conditions of the Original Order, as amended by the order dated March 30, 2004 ("Previous Order");

AND WHEREAS the MFDA requested in an application dated March 18, 2008 that Schedule A to the Previous Order be amended to delete the definition of "Public Director", which application is currently under consideration by the Commission;

AND WHEREAS the Commission has determined that it is not prejudicial to the public interest to issue an order that amends and restates the Previous Order to amend Schedule A to this order to extend the suspension of Rule 2.4.1 until December 31, 2010, to allow time for the MFDA to develop proposed amendments to Rule 2.4.1 regarding the direction of commissions to unregistered corporations;

IT IS ORDERED pursuant to section 144 of the Act that the Previous Order be amended and restated as follows:

IN THE MATTER OF
THE SECURITIES ACT, R.S.O. 1990, CHAPTER S.5,
AS AMENDED (the "Act")

AND

IN THE MATTER OF
MUTUAL FUND DEALERS ASSOCIATION OF CANADA/
ASSOCIATION CANADIENNE DES COURTIERES DE FONDS MUTUELS
(the "MFDA")

RECOGNITION ORDER
(Section 21.1)

WHEREAS the Commission recognized the MFDA as a self-regulatory organization for mutual fund dealers on February 6, 2001 ("~~Previous~~Original Order"), subject to terms and conditions;

AND WHEREAS the Commission issued an order dated March 30, 2004, amending and restating the terms and conditions of the Original Order;

AND WHEREAS the Commission issued an order dated November 3, 2006, varying the terms and conditions of the Original Order, as amended by order dated March 30, 2004 ("Previous Order");

AND WHEREAS the MFDA requested in an application dated ~~October 24, 2003~~ March 18, 2008, that ~~certain~~ changes be made to the Previous Order to remove the definition of public director, which application is currently under consideration by the Commission;

AND WHEREAS the MFDA has requested in an application dated July 17, 2008, that Schedule A to the Previous Order be amended to extend the suspension of MFDA Rule 2.4.1 until December 31, 2010;

~~**AND WHEREAS** the Board of Directors of the MFDA has passed amendments to the MFDA's by laws to change the MFDA's governance structure in order to provide for a proper balance among the interests of MFDA members and appropriate representation of individuals who represent the public interest on the MFDA Board of Directors and its committees and bodies;~~

~~**AND WHEREAS** the MFDA intends to enter into arrangements with other parties, subject to the consent of the Commission, for such other parties to perform the function of enforcing compliance by MFDA members, who conduct securities related business in Quebec, with the MFDA's or such other parties' substantially similar by laws, rules, regulations, policies, forms, and other similar instruments;~~

~~**AND WHEREAS** certain terms and conditions of the Previous Order were transitional in nature and the Commission is satisfied that the MFDA has met those terms and conditions;~~

~~**AND WHEREAS** the MFDA will continue to regulate, in accordance with its Rules, the operations and the standards of practice and business conduct of its members and their Approved Persons as defined under its Rules;~~

~~**AND WHEREAS** the Commission has considered the application and related submissions of the MFDA for continued recognition as a self-regulatory organization for mutual fund dealers;~~

~~**AND WHEREAS** the Commission has received certain representations and acknowledgements from the MFDA in connection with the MFDA's continued recognition as a self-regulatory organization;~~

~~**AND WHEREAS** the Commission considers it appropriate to set out in an order the terms and conditions of MFDA's continued recognition as a self-regulatory organization for mutual fund dealers, which terms and conditions are set out in Schedule A attached;~~

~~**AND WHEREAS** the MFDA has agreed to the terms and conditions set out in Schedule A;~~

~~**AND WHEREAS** the Commission is satisfied that MFDA recognition continues to be in the public interest;~~

~~**THE COMMISSION HEREBY AMENDS AND RESTATES** the MFDA's recognition as a self-regulatory organization so that the recognition pursuant to section 21.1 of the Act continues, subject to the terms and conditions attached as Schedule A.~~

~~March 30, 2004.~~

~~"Susan Wolburgh Jenah"~~

~~"David A. Brown"~~

SCHEDULE A

**TERMS AND CONDITIONS OF RECOGNITION OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA
AS A SELF-REGULATORY ORGANIZATION FOR MUTUAL FUND DEALERS**

1. DEFINITIONS

For the purposes of this Schedule:

"Approved Person" has the same meaning as that under the MFDA rules, as amended by the MFDA and approved by the Commission from time to time;

"member" means a member of the MFDA;

"rules" means the by-laws, rules, regulations, policies, forms, and other similar instruments of the MFDA;
and

"securities legislation" has the same meaning as that defined in National Instrument 14-101.

2. STATUS

The MFDA is and shall remain a not-for-profit corporation.

3. CORPORATE GOVERNANCE

(A) The MFDA's arrangements with respect to the appointment, removal from office and functions of the persons ultimately responsible for making or enforcing the rules of the MFDA, being the Board of Directors (the "Board"), shall secure a proper balance between the interests of the different members of the MFDA in order to ensure diversity of representation on the Board. In recognition that the protection of the public interest is a primary goal of the MFDA, a reasonable number and proportion of directors on the Board and on the committees of the Board shall be and remain during their term of office Public Directors and a Public Director is a director:

- (i) who is not a current director (other than a Public Director), officer or employee of, or of an associate or affiliate of:
 - (a) the MFDA,
 - (b) any protection or contingency fund in which Members (at the time the director holds the relevant office) are required to participate, or
 - (c) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
- (ii) who is not a current director, partner, significant shareholder, officer, employee or agent of a Member, or of an associate or affiliate of a Member, of:
 - (a) the MFDA,
 - (b) any protection or contingency fund in which Members (at the time the director holds the relevant office) are required to participate, or
 - (c) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
- (iii) who is not a current employee of a federal, provincial or territorial government or a current employee of an agency of the Crown in respect of such government;
- (iv) who is not a current member of the federal House of Commons or member of a provincial or territorial legislative assembly;
- (v) who has not, in the two years prior to election as a Public Director, held a position described in (i)-(iv) above;

- (vi) who is not:
 - (a) an individual who provides goods or services to and receives direct significant compensation from, or
 - (b) an individual who is a director, partner, significant shareholder, officer or employee of an entity that receives significant revenue from services the entity provides to, if such individual's compensation from that entity is significantly affected by the services such individual provides to,the MFDA or any protection or contingency fund in which Members are required to participate, or a Member of the MFDA; and
- (vii) who is not a member of the immediate family of the persons listed in (i)-(vi) above.

For the purposes of this definition:

- (a) "significant compensation" and "significant revenue" means compensation or revenue the loss of which would have, or appear to have, a material impact on the individual or entity, and
- (b) "significant shareholder" means an individual who has an ownership interest in the voting securities of an entity, or who is a director, partner, officer, employee or agent of an entity that has an ownership interest in the voting securities of another entity, which voting securities in either case carry more than 10% of the voting rights attached to all voting securities for the time being outstanding.

(B) The MFDA's governance structure shall provide for:

- (i) at least 50% of its directors, other than its President and Chief Executive Officer, shall be Public Directors;
- (ii) the President and Chief Executive Officer of the MFDA is deemed to be neither a Public Director nor a non-Public Director;
- (iii) appropriate representation of Public Directors on committees and bodies of the Board, in particular:
 - (a) at least 50% of directors on the governance committee of the Board shall be Public Directors,
 - (b) a majority of directors on the audit committee of the Board shall be Public Directors,
 - (c) at least 50% of directors on the executive committee of the Board, if any, shall be Public Directors,
 - (d) meetings of the Board shall have a quorum requirement of a reasonable number and proportion of Public Directors and non-Public Directors, with at least two Public Directors, and
 - (e) meetings of any committee or body of the Board shall have a quorum requirement of a reasonable number and proportion of Public Directors and non-Public Directors, provided that if the committee or body has Public Directors then the quorum must require at least one Public Director be present;
- (iv) the remaining number of directors serving on the Board and on the above referred to committees and bodies of the Board, shall consist of directors representing the different members of the MFDA to ensure diversity of representation on the Board in accordance with paragraph (A);
- (v) appropriate qualification, remuneration, and conflict of interest provisions and provisions with respect to the limitation of liability of and indemnification protection for directors, officers and employees of the MFDA; and

- (vi) a chief executive officer and other officers, all of whom, except for the chair of the Board, are independent of any member.

4. FEES

- (A) Any and all fees imposed by the MFDA on its members shall be equitably allocated and bear a reasonable relation to the costs of regulating members, carrying out the MFDA's objects and protecting the public interest. Fees shall not have the effect of creating unreasonable barriers to membership and shall be designed to ensure that the MFDA has sufficient revenues to discharge its responsibilities.
- (B) The MFDA's process for setting fees shall be fair, transparent, and appropriate.

5. COMPENSATION OR CONTINGENCY TRUST FUNDS

The MFDA shall co-operate with compensation funds or contingency trust funds that are from time to time considered by the Commission under securities legislation to be compensation funds or contingency trust funds for mutual fund dealers and with any such fund that has applied to the Commission to be considered such funds (the "IPPs"). The MFDA shall ensure that its rules give it the power to assess members, and require members to pay such assessments, on account of assessments or levies made by or in respect of an IPP.

6. MEMBERSHIP REQUIREMENTS

- (A) The MFDA's rules shall permit all properly registered mutual fund dealers who satisfy the membership criteria to become members thereof and shall provide for the non-transferability of membership.
- (B) Without limiting the generality of the foregoing, the MFDA's rules shall provide for:
 - (i) reasonable financial and operational requirements, including minimum capital and capital adequacy, debt subordination, bonding, insurance, record-keeping, new account, knowledge of clients, suitability of trades, supervisory practices, segregation, protection of clients' funds and securities, operation of accounts, risk management, internal control and compliance (including a written compliance program), client statement, settlement, order taking, order processing, account inquiries, confirmation and back office requirements;
 - (ii) reasonable proficiency requirements (including training, education and experience) with respect to Approved Persons of members;
 - (iii) consideration of disciplinary history, including breaches of applicable securities legislation, the rules of other self regulatory organizations or MFDA rules, prior involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally, of applicants for membership and any partners, directors and officers, in order that membership may, where appropriate, be refused where any of the foregoing have previously engaged in improper conduct, and shall be refused where the past conduct of any of the foregoing affords reasonable grounds for belief that the applicant's business would not be conducted with integrity;
 - (iv) reasonable consideration of relationships with other members and other business activities to ensure the appropriateness thereof; and
 - (v) consideration of the ownership of applicants for membership under the criteria established in paragraph 6(E).
- (C) The MFDA shall require members to confirm to the MFDA that persons that it wishes to sponsor, employ or associate with as Approved Persons comply with applicable securities legislation and are properly registered.
- (D) The MFDA rules shall require a member to give prior notice to the MFDA before any person or company acquires a material registered or beneficial interest in securities or indebtedness of or any other ownership interest in the member, directly or indirectly, or becomes a transferee of any such interests, or before the member engages in any business combination, merger, amalgamation, redemption or repurchase of securities, dissolution or acquisition of assets. In each case there may be appropriate exceptions in the case of publicly traded securities, de minimis transactions that do not involve changes in de facto or legal control or the acquisitions of material interests or assets, and non-participating indebtedness.

- (E) The MFDA rules shall require approval by the MFDA in respect of all persons or companies proposing to acquire an ownership interest in a member in the circumstances outlined in paragraph 6(D) and, except as provided in paragraph 6(F), for approval of all persons or companies that satisfy criteria providing for:
 - (i) consideration of disciplinary history, including breaches of applicable securities legislation, the rules of other self-regulatory organizations or MFDA rules, involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or civil proceedings involving business conduct or alleging fraudulent conduct or deceit, and prior business and other conduct generally; and
 - (ii) reasonable consideration of relationships with other members and involvement in other business activities to ensure the appropriateness thereof.
- (F) The MFDA rules shall give the MFDA the right to refuse approval of all persons or companies that are proposing to acquire an ownership interest in a member in the circumstances outlined in paragraph 6(D) who do not agree to:
 - (i) submit to the jurisdiction of the MFDA and comply with its rules;
 - (ii) notify the MFDA of any changes in his, her or its relationship with the member or of any involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings or in civil proceedings involving business conduct or alleging fraudulent conduct or deceit;
 - (iii) accept service by mail in addition to any other permitted methods of service;
 - (iv) authorize the MFDA to co-operate with other regulatory and self-regulatory organizations, including sharing information with these organizations; and
 - (v) provide the MFDA with such information as it may from time to time request and full access to and copies of any records.
- (G) The MFDA shall notify the Commission forthwith of members whose rights and privileges will be suspended or terminated or whose membership will be terminated, and in each case the MFDA shall identify the member, the reasons for the proposed suspension or termination and provide a description of the steps being taken to ensure that the member's clients are being dealt with appropriately.

7. COMPLIANCE BY MEMBERS WITH MFDA RULES

- (A) The MFDA shall enforce, as a matter of contract between itself and its members, compliance by its members and their Approved Persons with the rules of the MFDA and the MFDA shall cooperate with the Commission in ensuring compliance with applicable securities legislation relating to the operations, standards of practice and business conduct of members and Approved Persons, without prejudice to any action that may be taken by the Commission under securities legislation.
- (B) The MFDA shall conduct periodic reviews of its members and the members' Approved Persons to ensure compliance by its members and the members' Approved Persons with the rules of the MFDA and shall conduct such reviews at a frequency requested by the Commission or its staff. The MFDA shall provide notice to staff of the Commission of any material violations of securities legislation of which it becomes aware in the ordinary course operation of its business. The MFDA shall also cooperate with the Commission in the conduct of reviews of its members and the members' Approved Persons as requested by the Commission or its staff, to ensure compliance by its members and their Approved Persons with applicable securities legislation.
- (C) The MFDA shall promptly report to the Commission when:
 - (i) any member has failed to file on a timely basis any required financial, operational or other report;
 - (ii) early warning thresholds established by the MFDA that would reasonably be expected to raise concerns about a member's liquidity, risk-adjusted capital or profitability have been triggered by any member; and
 - (iii) any condition exists with respect to a member which, in the opinion of the MFDA, could give rise to payments being made out of an IPP, including any condition which, alone or together with other conditions, could, if appropriate corrective action is not taken, reasonably be expected to:

- (a) inhibit the member from promptly completing securities transactions, promptly segregating clients' securities as required or promptly discharging its responsibilities to clients, other members or creditors,
- (b) result in material financial loss, or
- (c) result in material misstatement of the member's financial statements.

The MFDA shall, in each case, identify the member, describe the circumstances that gave rise to the reportable event and describe the MFDA's proposed response to ensure the identified circumstances are resolved.

- (D) The MFDA shall promptly report to the Commission actual or apparent misconduct by members and their Approved Persons and others where investors, creditors, members, an IPP or the MFDA may reasonably be expected to suffer serious damage as a consequence thereof, including where the solvency of a member is at risk, fraud is present or there exist serious deficiencies in supervision or internal controls or non-compliance with MFDA rules or securities legislation. The MFDA shall, in each case, identify the member, the Approved Persons, or others, and the misconduct or deficiency as well as the MFDA's proposed response to ensure that the identified problem is resolved.
- (E) The MFDA shall advise the Commission promptly following the taking of any action by it with respect to any member in financial difficulty.
- (F) The MFDA shall promptly advise each other self-regulatory organization and IPP of which a member is a participant or which provides compensatory coverage in respect of the member, of any actual or apparent material breach of the rules thereof of which the MFDA becomes aware.

8. DISCIPLINE OF MEMBERS AND APPROVED PERSONS

- (A) The MFDA shall, as a matter of contract, have the right to and shall appropriately discipline its members and their Approved Persons for violations of the rules of the MFDA and shall cooperate with the Commission in the enforcement of applicable securities legislation relating to the operations, standards of practice and business conduct of the members and Approved Persons, without prejudice to any action that may be taken by the Commission under securities legislation.
- (B) The MFDA rules shall enable it to prevent the resignation of a member from the MFDA if the MFDA considers that any matter affecting the member or any registered or beneficial holder of a direct or indirect ownership interest in securities, indebtedness or other interests in the member, or in a person or company associated or affiliated with the member or affecting the member's Approved Persons or any of them, should be investigated or that the member or any such person, company or Approved Person should be disciplined.
- (C) The MFDA shall require its members and their Approved Persons to be subject to the MFDA's review, enforcement and disciplinary procedures.
- (D) The MFDA shall notify
 - (i) the Commission in writing, and
 - (ii) the public and the media
 - (a) of any disciplinary or settlement hearing, as soon as practicable and in any event not less than 14 days prior to the date of the hearing, and
 - (b) of the disposition of any disciplinary action or settlement, including any discipline imposed, and shall promptly make available any written decision and reasons.
- (E) Any notification required under paragraph 8 (D) shall include, in addition to any other information specified in paragraph 8 (D), the names of the member and the relevant Approved Persons together with a summary of circumstances that gave rise to the proceedings.
- (F) The MFDA shall maintain a register to be made available to the public, summarizing the information which is required to be disclosed to the Commission under paragraphs 8 (D) and (E).

- (G) The information given to the Commission under paragraphs 8 (D) and (E) will be published by the Commission unless the Commission determines otherwise.
- (H) The MFDA shall at least annually review all material settlements involving its members or their Approved Persons and their clients with a view to determining whether any action is warranted, and the MFDA shall prohibit members and their Approved Persons from imposing confidentiality restrictions on clients vis-à-vis the MFDA or the Commission, whether as part of a resolution of a dispute or otherwise.
- (I) Disciplinary and settlement hearings shall be open to the public and media except where confidentiality is required for the protection of confidential matters. The criteria and any changes thereto for determining these exceptions shall be specified and submitted to the Commission for approval.

9. DUE PROCESS

The MFDA shall ensure that the requirements of the MFDA relating to admission to membership, the imposition of limitations or conditions on membership, denial of membership and termination of membership are fair and reasonable, including in respect of notice, an opportunity to be heard or make representations, the keeping of a record, the giving of reasons and provision for appeals.

10. PURPOSE OF RULES

- (A) The MFDA shall, subject to the terms and conditions of its recognition and the jurisdiction and oversight of the Commission in accordance with securities legislation, establish such rules as are necessary or appropriate to govern and regulate all aspects of its business and affairs and shall in so doing:
 - (i) seek to ensure compliance by members and their Approved Persons with applicable securities legislation relating to the operations, standards of practice and business conduct of the members;
 - (ii) seek to prevent fraudulent and manipulative acts and practices and to promote the protection of investors, just and equitable principles of trade and high standards of operations, business conduct and ethics;
 - (iii) seek to promote public confidence in and public understanding of the goals and activities of the MFDA and to improve the competence of members and their Approved Persons;
 - (iv) seek to standardize industry practices where appropriate for investor protection;
 - (v) seek to provide for appropriate discipline;and shall not:
 - (vi) permit unfair discrimination among investors, mutual funds, members or others; or
 - (vii) impose any barrier to competition that is not appropriate.
- (B) Unless otherwise approved by the Commission, the rules of the MFDA governing the conduct of member business regulated by the MFDA shall afford investors protection at least equivalent to that afforded by securities legislation, provided that higher standards in the public interest shall be permitted and are encouraged.

11. RULES AND RULE-MAKING

- (A) No new rules, changes to rules (which shall include any revocation in whole or in part of a rule) or suspension of rules shall be made effective by the MFDA without prior approval of the Commission. Any such rules, changes or suspensions shall be justified by reference to the permitted purposes thereof (having regard to paragraph 10). The approval process shall be subject to a memorandum of understanding between the Commission and the MFDA to be established regarding the review and approval of rules and amendments and suspensions thereto.
- (B) Prior to proposing a new rule, changes to a rule (which shall include any revocation in whole or in part of a rule) or a suspension of a rule, the Board shall have determined that the entry into force of such rule or change or the suspension of the rule would be in the public interest and every proposed new rule, change or suspension must be accompanied by a statement to that effect.

- (C) All rules, changes to rules and suspensions of rules adopted by the Board must be filed with the Commission.
- (D) A copy of all written notices relevant to the rules or to the business and activities of members, their Approved Persons or other employees or agents to assist in the interpretation, application of and compliance with the rules and legislation relevant to such business and activities shall be provided to the Commission.
- (E) The MFDA shall, wherever practicable, document its interpretations of its rules and distribute copies of that documentation to its members and the Commission.

12. OPERATIONAL ARRANGEMENTS AND RESOURCES

- (A) The MFDA shall have adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules. With the consent of the Commission, the arrangements for monitoring and enforcement may make provision for the following:
 - (i) one or more parts of those functions to be performed (and without affecting its responsibility) by another body or person that is able and willing to perform it; and
 - (ii) its members and their Approved Persons to be deemed to be in compliance with its rules by complying with the substantially similar rules of such other body or person.

The Commission's consent may be varied or revoked from time to time and may be subject to terms and conditions.

- (B) The MFDA shall respond promptly and effectively to public inquiries and generally shall have effective arrangements for the investigation of complaints (including anonymous complaints) against its members or their Approved Persons. With the consent of the Commission, such arrangements may make provision for one or more parts of that function to be performed on behalf of the MFDA (and without affecting its responsibility) by another body or person that is able and willing to perform it. The Commission's consent may be varied or revoked from time to time and may be subject to terms and conditions. The MFDA and any other body or person performing such function on behalf of the MFDA shall not refrain from investigating complaints due to the anonymity of the complainant where the complaint is otherwise worthy of investigation and sufficiently detailed to permit investigation.
- (C) The MFDA shall ensure that it is accessible to the public and shall designate and make available to the public the names and telephone numbers of persons to be contacted for various purposes, including making complaints and enquiries.
- (D) The arrangements and resources referred to in paragraphs (A) and (B) above shall consist at a minimum of:
 - (i) a sufficient complement of qualified staff, including professional and other appropriately trained staff;
 - (ii) an adequate supervisory structure;
 - (iii) adequate management information systems;
 - (iv) a compliance department and an enforcement department with appropriate reporting structures directly to senior management, and with written procedures wherever practicable;
 - (v) procedures and structures that minimize or eliminate conflicts of interest within the MFDA;
 - (vi) inquiry and complaint procedures and a public information facility, including with respect to the discipline history of members and their Approved Persons;
 - (vii) guidelines regarding appropriate disciplinary sanctions; and
 - (viii) the capacity and expertise to hold disciplinary hearings (including regarding proposed settlements) utilizing public representatives within the meaning of the current section 19.5 of the MFDA's By-Law No. 1 together with member representatives.
- (E) The MFDA shall cooperate and assist with any reviews, scheduled or unscheduled, of its self-regulatory functions by an IPP or the Commission. In addition, in the event that the Commission is of the view that there has been a serious actual or apparent failure in the MFDA's fulfilment of its self-regulatory functions, the MFDA shall, where requested by the Commission, undergo an independent third party review on terms and by

a person or persons satisfactory to or determined by the Commission, which review shall be at the expense of the MFDA.

- (F) The MFDA shall cooperate and assist with any reviews, scheduled or unscheduled, of its corporate governance structure by the Commission. In addition, in the event that the Commission is of the view that there has been a serious weakness in the MFDA's corporate governance structure, the MFDA shall upon the request of the Commission undergo an independent third party review on terms and by a person or persons satisfactory to or determined by the Commission, which review shall be at the expense of the MFDA.
- (G) The MFDA shall not make material changes to its organizational structure, which would affect its self-regulatory functions, without prior approval of the Commission.
- (H) The MFDA shall comply with reporting requirements set out in Appendix A, as amended from time to time by the Commission or its staff. The MFDA shall also provide the Commission with other reports, documents and information as the Commission or its staff may be reasonably request.

13. INFORMATION SHARING

The MFDA shall cooperate, by sharing information and otherwise, with IPPs, the Commission and its staff, and other Canadian federal, provincial and territorial recognized self-regulatory organizations and regulatory authorities, including without limitation, those responsible for the supervision or regulation of securities firms, financial institutions, insurance matters and competition matters. The Commission and its staff shall have unrestricted access to the books and records, management, staff and systems of the MFDA.

14. SUSPENSION OF MFDA RULE 2.4.1

MFDA Rule 2.4.1 is suspended and will continue to be suspended until December 31, ~~2008~~2010, in the Provinces of British Columbia, Saskatchewan, ~~Manitoba~~, Ontario and Nova Scotia, and during such period the MFDA shall comply with the following conditions:

- ~~(A) the MFDA shall co-operate with the Commission and its staff, including participating on any joint industry and regulatory committee struck by the Commission and its staff, in their efforts to develop amendments to applicable securities legislation that would, among other things, allow an Approved Person to carry on securities related business (within the meaning of the MFDA rules) through a corporation, while preserving that Approved Person's and the member's liability to clients for the Approved Person's actions;~~
- (BA) the MFDA shall, as a condition of a member or Approved Person being entitled to rely on the suspension of Rule 2.4.1, require that the member and its Approved Persons agree, and cause any recipient of commissions on behalf of Approved Persons that is itself not registered as a dealer or a salesperson to agree, to provide to the MFDA, the Commission and the applicable member access to its books and records for the purpose of determining compliance with the rules of the MFDA and applicable securities legislation;
- (EB) the MFDA shall ensure in connection with the suspension of Rule 2.4.1 that members and Approved Persons comply with the remaining Rules, with specific reference to Rule 1 Business Structures and Qualifications, Rule 1.2.1(d) Dual Occupations and the requirement noted above in paragraph (BA);
- (EC) the MFDA shall ensure that members applying for membership are made aware of the requirements of Rule 1 by delivering to each applicant a copy of its Notice MR-0002; and
- (ED) the MFDA shall not accept a member whose relationship with its Approved Persons does not comply with the rules of the MFDA and in particular, Rule 1, unless the MFDA has granted exemptive relief to that applicant under the authority granted to the Board of Directors under section 38 By-law No. 1.

APPENDIX A

Reporting Requirements

1. Prior Notification

- 1.1 The MFDA shall advise the Commission in advance of any proposed material changes or reductions in its financial review program or operational and sales compliance review programs, including as to procedures or scope, or any proposed changes in its external audit instructions and of any proposed material changes or reductions in the operation of its investigation or enforcement programs.

2. Immediate Notification

- 2.1 The MFDA shall give the Commission notice of new directors, officers and committee chairpersons, including a 5 year employment history and information as to the involvement in criminal, relevant quasi-criminal, administrative or insolvency proceedings and civil proceedings involving business conduct or alleging fraudulent conduct or deceit in respect of each such person.

3. Annual Reporting

The MFDA shall within 120 days of its fiscal year end file the following information and reports to the Commission:

- 3.1 The MFDA's self-regulatory staff complement, by function, and of any material changes or reductions in self-regulatory staff, by function;
- 3.2 Copy or summary of self-assessment by management of the MFDA's performance of its self-regulatory responsibilities and any proposed actions arising therefrom. The self-assessment shall, for each of the MFDA's member regulatory functions, set performance measurements against which performance can be compared, and identify major successes, significant problem areas, plans to resolve these problems, recruitment and training plans, and other information as reasonably requested by the Commission or its staff; and
- 3.3 The MFDA's budget and audited financial statements.