



**RESTRUCTURING OF THE
CHAMBRE DE LA SÉCURITÉ FINANCIÈRE**

INFORMATION CIRCULAR

APRIL 2007

Message from Management

April 2007

We are pleased to submit, for examination, this Information Circular regarding the Restructuring Project of the *Chambre de la sécurité financière*.

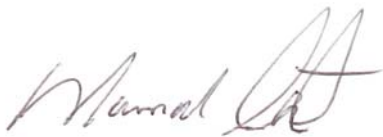
The Chamber's Board of Directors approved the principle of this Project on December 8, 2006. The practical elements of the restructuring described in this Circular have been elaborated since then and have been the topic of certain preliminary discussions with stakeholders, including the *Autorité des marchés financiers*.

Guided by our wish to protect the raison d'être of the Chamber in each of the six sectors it currently oversees, it seemed essential to us to begin repositioning the Chamber so that it can contribute to the success of the reforms resulting from the establishment of the Canada-wide securities passport system including, before the end of this year, the implementation of the intermediaries' registration regime by the Canadian securities regulators.

However, in our view, this repositioning requires a structural adjustment so as to enable the Chamber to meet, effectively and at the least cost possible, the new challenges of nation-wide supervision that group savings plan firms will have to face following these reforms. This development in fact prompts us to broaden our current scope of intervention as a self-regulatory organization.

Whether you are a representative who is a member of the Chamber, a firm, or any other interested party, this Circular will provide you with the information you need to properly understand our restructuring project and assess its impacts on your situation. It will also, we hope, help you better appreciate the objectives that prompted us to promote it.

Just like the Chamber's board members, we would be pleased to consider any comments and suggestions you wish to communicate to us regarding this matter.



Normand Caty
Chairman of the Board
Financial Planner
Financial Security Advisor
Group Savings Representative



Luc Labelle, M.Sc.
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1. Background

1.1 *Self-regulatory role of the Chamber*

Since its creation in 1999, the *Chambre de la sécurité financière* ("**Chamber**"), a self-regulatory organization ("**SRO**") recognized in Quebec under the *Act respecting the distribution of financial products and services* ("**Distribution Act**"), supervises more than 30,000 members¹ by overseeing their ethics and ongoing training² and managing a disciplinary process primarily intended to prevent lapses in behaviour prejudicial to the public. It has no direct authority over firms, which are regulated by the *Autorité des marchés financiers* ("**AMF**") under the *Distribution Act*.

To this extent, the Chamber plays the role of an SRO in the sectors that group :

- investment funds³ (hereinafter "**group savings plans**");
- scholarship plans and investment contracts (that, together with group savings, represent the securities disciplines governed by the *Distribution Act*), individual insurance of persons, group insurance of persons and financial planning (hereinafter collectively referred to as "**other financial security disciplines**").

It carries out this role under the supervision of the AMF, its regulator that is a member of the Canadian Securities Administrators ("**CSA**").

This SRO status, granted directly to the Chamber by the *Distribution Act*, also allows the AMF to delegate to the latter, subject to certain conditions, powers relating to securities for the purpose of self-regulation of its members. To date, the AMF has not yet exercised this additional delegation power in favour of the Chamber.

1.2 *Passport System*

On December 14, 2006, the bill to amend the *Securities Act* and other legislative provisions was adopted to facilitate the implementation of the Quebec component of the Canadian Passport System (the "**Securities Passport**").⁴

Among other measures, this legislation amended the *Securities Act* to allow for the mutual delegation of responsibilities and powers among members of the CSA as well as subdelegation, from a CSA member to an SRO it will have recognized, of powers delegated to it.

Once each CSA member will have been invested with the powers of the others by delegation, it will be possible, in particular, for a firm to register as a group savings broker

¹ These members are representatives in the sectors of individual insurance of persons, group insurance of persons, group savings plans, investment contracts and scholarship plans who do not conduct business for a dealer with an unrestricted practice or a discount broker within the meaning of the *Securities Act*, and financial planners.

² Excluding financial planners.

³ If the representatives concerned do not conduct business for a dealer with an unrestricted practice or a discount broker within the meaning of the *Securities Act*.

⁴ The Securities Passport will be based on a set of harmonized regulatory obligations that are to be interpreted and applied uniformly across Canada.

by applying to the CSA member in his province or territory and benefit from Canada-wide registration.⁵

1.3 *New Registration Regime*

On March 28, 2007, the CSA published draft *Regulation 11-102 respecting Passport System*, for comment until May 28, 2007. At the same time, the CSA stipulated that Regulation 11-102 would be phased in as of the beginning of 2008 when draft *Regulation 31-103 respecting registration* (the "**Registration Regime**") will have taken effect.

The Registration Regime will be one of the main components of the Securities Passport. It will provide for uniformity among all provinces and territories having chosen to adopt it.

On February 20, 2007, the AMF launched a consultation on the new Registration Regime. The documents published on this occasion show that the harmonization of the Canadian regulatory framework, proposed by the Securities Passport and applied in the new Registration Regime, will fundamentally impact the legislative bases on which the Chamber's current actions are founded:

- first, the proposed Registration Regime would have the effect, in Quebec, of withdrawing the regulation of the sale and distribution of group savings plans, scholarship plans and investment contracts from the *Distribution Act* so that these matters would be governed by the *Securities Act*, as was the case before 1999;
- second, to help ensure that the regulatory framework would remain harmonized in the future, as required under the Securities Passport, the CSA has decided to resort more extensively to self-regulation for the group savings plan sector; outside Quebec, it would rely on the Mutual Fund Dealers Association ("**MFDA**"), which would be the SRO responsible for the supervision of this sector; in Quebec, where the MFDA is not currently present, an SRO to be determined would assume broader powers than those now exercised by the Chamber under the *Distribution Act*;
- third, the SRO responsible for regulating the group savings plan sector in Quebec would henceforth intervene via group savings brokers within the meaning of draft Regulation 31-103 (currently called "**firms**" in Quebec), and not only via representatives, as the Chamber now does.

If there is no major repositioning of the Chamber as a securities SRO, it follows that only the MFDA would be in the running to be recognized as the SRO for group savings plans in Quebec and thereby take over the Chamber's former responsibilities in this field. The Chamber would also lose its role as the SRO for group savings plan representatives and thus a large part of its multidisciplinary functions.

The possibility of seeing the Chamber's responsibilities reduced in terms of group savings plans and the corresponding transfer of these responsibilities to the MFDA, an SRO neither

⁵ See the CSA bulletin entitled *Canadian Regulators Seek Comment on Passport System, March 28, 2007*. For the time being, Ontario is not participating in the Securities Passport, but it is however to be expected that this province's securities commission will harmonize its own registration rules with the new Securities Passport system, if one is to believe the comments of the OSC chair, who is expecting the creation of an "interface" with the other CSA members on this issue: *OSC goes on record against "passport" model*, *The Globe and Mail*, March 29, 2007. See also Notice 11-904 published by the OSC on March 28, 2007.

based nor recognized in Quebec, is rather disquieting for us. The AMF has paid special attention to this issue and is now seeking comment from the public on this matter.

1.4 Consultation on the regulatory framework applicable to the group savings plan sector

On February 20, 2007, at the same time as it was launching its consultation on the new Registration Regime (31-103), the AMF published another document entitled "*Consultation on the regulatory framework applicable to the mutual fund sector further to the Registration Reform project*" ("**Consultation Document**") (the text of which is attached as Appendix A to this Circular).

The purpose of this second consultation, which is being conducted concurrently with the one on the Registration Regime but will end about two months earlier (i.e., on April 23, 2007), is to seek comment, that will allow the AMF to adopt a position on the self-regulation model that it should approve to give effect to the directions of the new Registration Regime, while taking into account the realities of Quebec.

To that end, the AMF's Consultation Document puts forward three specific options for consideration by interested parties :

Option 1 : *Recognition of the MFDA as the SRO responsible in Quebec (firms⁶ and representatives).*

Option 2 : *Recognition of the MFDA in Quebec (firms and representatives), but outsourcing its responsibilities related to representatives to the Chambre de la sécurité financière (Chamber).*

Option 3 : *Recognition of the Chamber as the SRO responsible in Quebec (firms and representatives) and adoption by the Chamber of all MFDA rules.*

Option 3 is obviously the one that is closest to the position adopted by the Chamber, since it is based on information the AMF had at the time further to some preliminary discussions with the Chamber.⁷ This Circular details some of the elements of this option.⁸

In order to respond to this Consultation Document as accurately as possible, the Chamber deemed it wise to begin an information process to tell firms about the work it has accomplished over the last few months in preparation for the introduction of the Securities Passport. This was also the reason that prompted us to prepare this Circular.

This information process is also designed to provide firms and other interested parties with first-hand information on the corporate and operational Restructuring Project that the Chamber would be prepared to undertake.

⁶Note that firms will become brokers further to 31-103.

⁷ See section 6.7 of the AMF's Consultation Document attached to this Circular as Appendix A herein.

⁸ Given that the information on option 3 was submitted as a proposal by the Chamber in response to the Consultation Document, the Chamber felt justified in supplementing this information by means of this Circular, so that interested parties will have complete information before adopting a position.

2. Summary of the planned Restructuring Project

2.1 *Group savings plan discipline*

As regards group savings plans, the Chamber proposes :

- to cease being an organization created and operating under the *Distribution Act*;
- to continue as a private corporation providing regulatory and supervisory services ("*Financial Security--Self-Regulation*" or "**FSSR**") governed by the same corporate law as the MFDA, i.e. a non-profit corporation;
- to harmonize the organization, the mission and the powers of FSSR with those of the MFDA so as to operate more or less in the same manner and to the same extent, while reserving for firms, in its governance structure, representation and leverage equal to that offered by the MFDA in its decisional processes related to group savings plans;
- to become a recognized SRO within the meaning of the *Act respecting the Autorité des marchés financiers*, no longer governed by the *Distribution Act* but rather by the *Securities Act*;
- to require that the AMF delegate powers equal to those conferred on the MFDA by the other Canadian regulators and the power to regulate Canadian operations of firms having their head offices in Quebec;
- to conclude with the MFDA the agreements and administrative arrangements required to act in partnership (jointly or on an outsourcing basis, as the case may be with the MFDA for all matters regarding the supervision of the solvency of firms based in Quebec, to control and supervise their Canadian operations and, via outsourcing by the MFDA, to control and supervise the operations in Quebec of firms that are members of the MFDA and have their head offices outside of Quebec.

2.2 *Other disciplines*

Moreover, this restructuring would allow the Chamber, in its new form as a private regulated body under the *Securities Act*, to keep its multidisciplinary functions and the powers, rights and duties of a *chambre de la sécurité financière* referred to in the *Distribution Act* as regards the ethics and ongoing training of representatives conducting business in the other financial security disciplines.

The FSSR governance system would be adapted accordingly so that only the classes of interested members (firms, representatives or both, as the case may be) are involved in discussions and decisions on issues that concern them.

2.3 *Net result of the restructuring*

Once the different phases of the Chamber's corporate restructuring have been completed, the *Assemblée nationale* has amended the *Distribution Act* and the

Securities Act to implement the new securities Passport system and Registration Regime,⁹ the memoranda of understanding and outsourcing agreements required between FSSR and the MFDA have been concluded and the mutual delegations and subdelegations of powers of the AMF and other Canadian regulators (whether or not parties to the Securities Passport) have been granted to FSSR, it will act as :

- the only delegate SRO in Quebec of the AMF's powers and the only Quebec subdelegate SRO of the powers of other Canadian regulators with jurisdiction over the Canadian operations of group savings plan firms having their head offices in Quebec ("**Quebec group savings plan SRO**");
- the recognized SRO exercising the same powers, rights and privileges as those that are currently reserved for the Chamber under the *Distribution Act* as regards discipline, ongoing training and ethics of those among its members who conduct business in other financial security disciplines.

The main elements of this restructuring, described below, are presented in an annotated table in **Appendix B** of this Circular.

3. Detailed description of the key steps of the Project

3.1 Creation of a new non-profit organization (NPO)

As the first step of the Project, the Chamber will have to create a new non-profit corporation under the *Canada Corporations Act*, i.e. the same statute as the one under which the MFDA was created.

The FSSR's letters patent, articles, by-laws, instructions and directives ("**Corporate Documents**") will be aligned with those of the MFDA in terms of the FSSR's role as the SRO for group savings plans in Quebec.

These Corporate Documents will also include all the provisions required to allow the FSSR to continue to fulfil the Chamber's current role (ethics and ongoing training) with respect to representatives conducting business in other financial security disciplines.

3.2 Amendments to the *Distribution Act*

The implementation of the new Registration Regime, as proposed by the AMF, will require amendments to the *Distribution Act* so that group savings plan, scholarship plan and investment contract firms and their representatives will no longer be governed by this Act but by the *Securities Act* instead.

These amendments, which will have to be made anyway, would be an opportune time to :

⁹ These amendments would include the few provisions concerning the new raison d'être of the Chamber, which would have become an FSSR: see Section 3.2 below.

- designate the FSSR, in the *Securities Act*, as the Quebec group savings plan SRO;¹⁰
- provide in the *Securities Act* that the FSSR will discharge, according to the terms and through the governance structures provided for in its Corporate Documents, the supervisory and disciplinary responsibilities of a chambre de la sécurité financière (as opposed to the present-day Chamber) as regards representatives certified in a sector other than group savings plans;
- amend the *Distribution Act*, specifically its Title V, to provide essentially that the responsibilities of a *chambre de la sécurité financière* can be discharged by the FSSR as regards representatives certified in another financial security discipline;
- provide that certain powers pertaining to investigations and the carrying out the decisions of a *chambre de la sécurité financière* can be exercised by the FSSR, thereby allowing it to keep some of the powers the Chamber now holds in this regard (specifically: homologation and the power to enforce the attendance of witnesses);
- enact transitional provisions providing for the transfer of the property, rights and obligations of the Chamber to the FSSR, in particular as regards discipline; these transitional provisions will stipulate that the Chamber's by-laws will continue to apply to representatives conducting business in other financial security disciplines.

3.3 *Delegation of functions and powers related to securities*

The FSSR will ask the AMF to delegate, in matters of group savings plans, responsibilities and powers identical to those that CSA members have delegated to the MFDA elsewhere than in Quebec, including those regarding:

- supervision and solvency of firms;
- monitoring the competence, integrity and proper conduct of the business of firms and representatives; and
- inspection.

3.4 *Memorandum of agreement between the FSSR and MFDA*

The FSSR and the MFDA would sign a memorandum of agreement providing in particular the following :

- ***collaboration and integrated approach***: the terms and conditions of their collaboration and integrated approach as regards supervision, inspection and regulation in the field of group savings plans across Canada and, in general, as regards the exercise of the powers delegated or subdelegated by CSA members to their respective members;

¹⁰ This designation would be made in the *Securities Act* itself, in the manner and on conditions with respect to supervision similar to those currently stipulated in the second paragraph of section 312 of the *Distribution Act* and would thus be accompanied by the power the AMF now holds to withdraw for cause from the FSSR its statutory recognition as an SRO.

- ***ongoing harmonization of rules***: a means of developing and adopting harmonized rules governing group savings plans across Canada;
- ***mutual outsourcing of services and assistance***: for the functions performed by the FSSR outside Quebec (regarding the operations outside Quebec of the FSSR member firms based in Quebec) and for those performed by the MFDA in Quebec (regarding the operations in Quebec of MFDA member firms not based in Quebec) the bases for the mutual outsourcing of services and timely assistance designed to network and fully integrate their respective self-regulation;
- ***compensation system***: the FSSR will recognize the MFDA's Investor Protection Corporation; membership in this system and fees from Quebec firms that have adopted the system will be a condition of membership in FSSR, and the Investor Protection Corporation will agree to make its guarantee applicable, for the benefit of Quebec clients, to transactions for which compensation is available that are carried out anywhere in Canada by these firms; the MFDA will also partner up with FSSR for the purposes of regulating solvency and ensuring the prudent supervision of firms conducting business in group savings plans in Quebec;
- ***transfers of expertise on a transitional basis***: transitional measures allowing for transfers of expertise and special conditions regarding assistance to make it easier for FSSR to take charge of its new supervisory activities as regards firms and specifically their prudent supervision.

4. Advantages created by the planned Restructuring Project

The Restructuring Project proposed by the Chamber would go even further than Option 3 of the AMF's Consultation Document¹¹ (see comparative table below) and would provide, in our view, greater advantages.

Given the now known features of the Passport System and the new securities Registration Regime, the Chamber is convinced that the recognition of FSSR as SRO for group savings plans in Quebec as well as the implementation of the Restructuring Project described herein represent the best solution to combine the benefits of the Chamber's multidisciplinary expertise, its comprehensive knowledge of group savings plan business practices in Quebec, its innovative approach to ethics and ongoing training, its strong regional presence throughout the province and its knowledge of the milieu.

¹¹ See section 1.4 below.

Comparison	
Option 3 of AMF Consultation Document	Restructuring Project of the Chamber
Registration of group savings plan dealers and their representatives would remain a function of the AMF.	Project in agreement.
Inspection of group savings plan dealers in Quebec would be delegated to the Chamber.	Project in agreement.
All group savings plan dealers conducting business in Quebec would have to join the Chamber.	Only firms <u>headquartered in Quebec</u> would have to join the Chamber (FSSR). Quebec operations of all firms (whether or not based in Quebec) would be supervised by FSSR under the memoranda of agreement with the MFDA as regards its members.
Group savings plan dealers conducting business both in and outside Quebec would have to join the MFDA.	Firms headquartered in Quebec with operations in Quebec and elsewhere in Canada would not be obliged to join the MFDA, but only FSSR. However, the operations outside Quebec of all firms (whether or not based in Quebec) would be supervised by the MFDA under the memoranda of agreement as regards our members.
Group savings plan dealers in Quebec would be governed by rules harmonized with those of the MFDA.	Project in agreement.
The organization, mission and powers of the Chamber would be harmonized with those of the MFDA as regards the regulatory framework of the group savings plan sector.	Project in agreement with statement. However, FSSR would also obtain the requisite subdelegations of power as CSA to be able to regulate and supervise the outside Quebec operations of firms headquartered in Quebec. The discharge of these powers would be governed by memoranda of agreement with the MFDA.
The Chamber would keep its current role and powers with respect to the insurance of persons sector.	Project in agreement. This role and these powers would however be exercised by FSSR in the capacity of SRO in securities, and no longer as the former <i>Chambre de la sécurité financière</i> under the <i>Distribution Act</i> . Thus, FSSR could continue the Chamber's role with respect to other financial security disciplines, and not only the insurance of persons sector.

Moreover, the Restructuring Project we are planning will also allow us to better achieve the key objectives of the new Registration Regime :

- harmonizing and streamlining the Registration System across Canada;
- achieving greater structural, operational and regulatory consistency by implementing a Canadian self-regulation network for group savings plans supported by FSSR and the MFDA;
- a structural guarantee to ensure harmonization in the distant future, as regards the rules governing the group savings plan sector in Canada and the application of these rules, given this networking;
- the proximity of the peer decision-making, control and supervision centre;
- establishing, among group savings plan dealers conducting business in more than one province or territory, equal regulatory conditions promoting a fairer competitive environment for firms;
- by being ready to go one step further in the logic of the Securities Passport than Option 3 of the Consultation Document, the Chamber's Restructuring Project will mean that firms headquartered in Quebec will only have to join and pay for the costs of only one SRO in group savings plans, the one that best knows the Quebec market, with all the obvious attendant benefits;
- firms based in Quebec that are current MFDA members can keep the vested rights as regards the contribution to the MFDA's Investor Protection Corporation, and the representatives of firms that conduct business only in Quebec will be able to offer their clients access to a compensation system in the event of the insolvency of these firms.

As to maintaining, in FSSR, the multidisciplinary functions and responsibilities of the Chamber as regards group savings plans and other financial security disciplines, we see many potential benefits both in terms of the consistency of the pertinent rules and the consistency of the application. The logic guiding us is essentially the same as the logic that guided AMF's numerous financial control and supervision components. It therefore promises efficiencies and savings for firms and representatives who can now save by having to deal with a single organization.

These benefits are also important for group savings plan representatives who continue to accumulate certificates under the *Distribution Act* and for multidisciplinary firms.

5. Additional information and comments

For more information or to comment on the Restructuring Project of the *Chambre de la sécurité financière*, we invite you to contact us at :

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

February 20, 2007

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1. PURPOSE OF CONSULTATION

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

To help fulfill its mission, the AMF is conducting a consultation with mutual fund firms (known as group savings plan firms), their representatives and a number of stakeholders from the industry concerning the impacts resulting from a reform of the registration regime (“reform”) as proposed under draft *Regulation 31-103 respecting registration requirements* (“Regulation 31-103”) published for comment on February 20, 2007. Regulation 31-103 and related documents are available on the AMF website at <http://www.lautorite.qc.ca/projets-speciaux/reforme-inscription.fr.html>.

This consultation is primarily geared toward certain legislative and regulatory impacts of reform on mutual fund firms and representatives, in particular recognition by the AMF of an industry self-regulatory organization.

Further to this consultation, the AMF will review the comments and propose measures to the ministère des Finances du Québec in order to ensure a harmonized and equitable regulatory framework for the mutual fund distribution sector, as well as appropriate transition periods.

2. BACKGROUND AND OBJECTIVES 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 and thereby help meet the need for harmonization and simplification.

As a result of reform, registration categories and conditions would be harmonized across Canada, with a revision of the National Registration Database (NRD). In particular, solvency and proficiency requirements will be identical and would therefore be applied consistently to all persons registered in a given category, regardless of the jurisdiction where their activities are carried on.

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.

3. NEW FEATURES FOR THE MUTUAL FUND DISTRIBUTION SECTOR

Reform would have major impacts on the mutual fund distribution sector in Québec. The AMF believes that the regulatory framework applicable to this sector in Québec should be identical to that in effect in the other Canadian jurisdictions following reform.

Impacts would include:

- a. Mutual fund firms (group savings plan firms) and their representatives, which are currently governed by the *Act respecting the distribution of financial products and services* (“Distribution Act”), would now be governed by the *Securities Act* (“SA”);
- b. With respect to net free capital and financial institution insurance requirements, mutual fund firms, which would become mutual fund dealers, would be subject to the rules of the Mutual Fund Dealers Association of Canada (“MFDA”), just like mutual fund dealers outside Québec; they would also be required to file the MFDA *Financial*

*Questionnaire and Report*¹ in its entirety.

The AMF submits the following elements for discussion:

1. Mutual fund firms in Québec should join a self-regulatory organization (“SRO”) that is specialized in the sector (an “industry SRO”);
2. The second paragraph, section 149 of SA,² 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, should be repealed.

4. CURRENT SUPERVISION OF MUTUAL FUND SECTOR IN QUÉBEC

The current regime in Québec governing mutual fund firms and their representatives differs markedly from the regime in force in other Canadian jurisdictions.

4.1 Mutual fund firms

Mutual fund firms are governed by the Distribution Act, which sets out a supervisory regime that is different from that under SA.

In particular, mutual fund firms are not:

- subject to a permanent registration system identical to that set out under SA and the *Securities Regulation* (“SR”), to which securities dealers and advisers are subject;
- required to join the MFDA or any other SRO;
- required to maintain a financial institution insurance policy or bond, but instead must maintain liability insurance for errors and omissions;
- required to maintain and calculate their regulatory capital (net free capital) according to the standards currently in effect in other jurisdictions.

The AMF believes that these specific requirements cannot form part of a passport registration system and should therefore no longer be maintained. It therefore proposes that mutual fund firms and their representatives be governed by a harmonized national regime.

4.2 Mutual fund representatives

Mutual fund representatives:

- are required, under section 312 of the Distribution Act, to be members of the *Chambre de la sécurité financière* (“CSF”) and to pay the annual contribution determined by CSF regulation (section 320 of the Distribution Act), subject to suspension of their certificate for failure to do so (section 320.3 of the Distribution Act);
- are subject to the jurisdiction of the CSF discipline committee which, under section 354 of the Distribution Act, “shall decide all complaints filed against representatives in insurance of persons, group insurance representatives, securities representatives

¹ <http://mfda.ca/regulation/forms.html>

² The restriction under section 149 of SA reads as follows: “Subject to such remunerated business as may be carried on under a government regulation made under this Act, the representative of a dealer acting as principal or as agent shall not concurrently carry on business as such and be employed by a financial institution, unless he is a representative specialized in group savings or scholarship plans.”

and financial planners”;

- may be employed by a financial institution, because the restriction set out in the second paragraph, section 149 of SA applies solely to representatives of a dealer acting as principal.

Question 1

Are there any disparities in the structures and operations of Québec-based markets, particularly with respect to the distribution methods for mutual fund securities, that could account for a distinction in regulatory requirements when compared with requirements in other jurisdictions?

4.3 Financial services compensation fund

Established pursuant to section 258 of the Distribution Act, the *Fonds d'indemnisation des services financiers* (financial services compensation fund) enables the AMF to pay indemnities to victims of fraud, fraudulent tactics (dishonest operations) or embezzlement as a result of dealings with individuals and firms authorized to operate under the Distribution Act.³

However, the fund does not cover cases in the event of insolvency unrelated to fraud.

The fund is made up of the annual dues that firms and representatives registered with the AMF under the Distribution Act are required to pay.

The AMF is not recommending any changes to the requirement that mutual fund firms and their representatives contribute to the financial services compensation fund. Nonetheless, the AMF seeks to ensure an equitable regulatory framework in this regard and is mindful that recognition of the MFDA as an industry SRO in Québec, as outlined in section 6 of this document, could give rise to dual contributions in respect of two compensation funds providing different coverage.

Indeed, the MFDA requires that members pay annual fees to the Investor Protection Corporation which, unlike the financial services compensation fund, covers only cases involving the insolvency of firms.

The AMF would therefore ensure that dues payable to the financial services compensation fund are taken into account in light of any contributions that Québec firms may be required to pay, as the case may be, to the Investor Protection Corporation in order not to increase the regulatory burden of these firms.

5. PROPOSED SUPERVISION OF MUTUAL FUND SECTOR IN QUÉBEC

5.1 Transition to Securities Act (“SA”)

New regime

Among proposed legislative amendments in support of reform, the Distribution Act would be amended so that the activities of mutual fund firms and their representatives⁴ would be

³ The AMF may also rule on the admissibility of claims under the *Regulation respecting the eligibility of a claim submitted to the Fonds d'indemnisation des services financiers* and decide the amount of the indemnities to be paid. Indemnities paid out of the compensation fund may total up to \$200,000 per claim.

⁴ The AMF also recommends that investment contract brokerage and scholarship plan brokerage activities be governed by SA.

governed by SA and Regulation 31-103.

The AMF proposes this legislative amendment for the following reasons:

- a. The AMF seeks to achieve greater equality of treatment in situations that are virtually similar and for which disparities in the treatment of registration categories do not seem justified;
- b. Current disparities in the treatment of mutual fund firms and dealers governed by SA compared with the treatment of mutual fund firms and persons registered in the sector in other jurisdictions present an obstacle to harmonization and the efficient operation of a passport registration system;
- c. Regulatory inconsistencies such as insurance and net free capital requirements for registrants as well as financial statement filings with the AMF complicates the framework for the distribution of securities in Québec.

Impact on registration fees payable and the maintenance of registration

Transitioning to a regime governed by SA would result in an increase in fees payable for registrations as well as for the annual maintenance of registrations.

The fees payable for a firm's registration and the annual fees required for registration maintenance are currently \$80 for each representative. The fees payable by a representative for the issuance of a certificate and the fees payable annually for its renewal are \$80.⁵

The fees payable under SR are substantially higher: Registration fees⁶ total \$1,500 for a dealer and \$375 for each representative. The fees payable for maintaining a registration total \$1,500 for a dealer, who is also required to pay \$75 for each establishment in Québec, and the fees payable for maintaining a representative's registration total \$375.

In summary:

	Firm/dealer	Representative
Distribution Act	Registration: \$80 for each representative Maintaining registration: \$80 for each representative	Certificate: \$80 Renewal of certificate: \$80
Securities Act	Registration: \$1,500 Maintaining registration: <ul style="list-style-type: none"> • \$1,500; and • \$75 for each establishment 	Registration: \$375 Maintaining registration: \$375

⁵ Fees payable under the Distribution Act are determined by the *Regulation respecting the dues, contributions and fees payable*; they are adjusted annually pursuant to section 23 of the Regulation.

⁶ Fees payable under SA are determined in subparagraph 1, section 271.5 of SR.

Question 2

A transition period must be determined the transition of mutual fund firms and representatives under SA. What would be an appropriate transition period under the circumstances?

5.2 Regulatory capitalBackground

Solvency of registered firms is ensured through compliance with the requirements related to regulatory capital ("net free capital" in Québec). The regulatory capital amount that mutual fund firms are required to maintain in Québec is currently equal to the sum obtained by adding \$50,000 to the deductible applicable to the firm's liability insurance policy. The formula for calculating capital is set out in the Appendix to the *Regulation respecting the trust accounts and financial resources of securities firms*.

New regime

Regulation 31-103 provides for a uniform regime under which registrants who are SRO members must calculate regulatory capital according to the requirements of the SRO, while registrants who are not SRO members⁷ must maintain and calculate regulatory capital according to the provisions and formula set out in Regulation 31-103.

Mutual fund firms registered outside Québec will still be required to maintain and calculate regulatory capital according to MFDA rules ("risk adjusted capital") and, more particularly, to file the MFDA's *Financial Questionnaire and Report* ("FQR").⁸

Québec mutual fund dealers would also be subject to MFDA's capital requirements and required to file FQR in its entirety with the industry SRO.

The requirements are as follows:

- \$50,000 for a firm that does not hold client cash, securities or other property;
- \$75,000 for a firm that does not hold client securities or other property, except client cash in a trust account;
- \$200,000 for any other registered firm.⁹

Question 3

Would mutual fund firms be able to comply with this new requirement? If not, explain why and indicate an appropriate transition period under the circumstances.

⁷

Firms that are not SRO members would be portfolio managers and exempt market dealers.

⁸

<http://mfda.ca/regulation/forms.html>

⁹

The insurance deductible is taken into account in each of these amounts.

5.3 Insurance

Background

The requirement whereby mutual fund firms and their representatives must hold liability insurance is intended to protect them against errors and omissions.

The requirement for firms is set out under section 29 of the *Regulation respecting firms, independent representatives and independent partnerships*. A firm's liability insurance coverage may not be less than \$500,000 per claim and, for each 12-month period, not less than \$1,000,000 for a firm with three representatives or fewer (\$2,000,000 for a firm with more than three representatives).

As for representatives, they are required, under the *Regulation respecting the pursuit of activities as a representative*, to hold liability insurance coverage that may not be less than \$500,000 per claim and \$1,000,000 per year.

On the other hand, Québec securities dealers have been required, since 1983, to maintain financial institution insurance, or a financial institution bond, under section 213 of SR. This is intended in particular to provide coverage against dishonest conduct or fraud by representatives as well as against loss of securities and forgery. This insurance regime applies to registrants in all jurisdictions.¹⁰

New regime

The AMF recommends that mutual fund dealers in Québec be required, as they are across Canada, to subscribe for financial institution insurance for coverage against dishonest conduct or fraud by representatives as well as against loss of securities and forgery. On the basis of insurance regimes applicable internationally, the AMF believes that the financial institution insurance would constitute a more suitable means of coverage in the circumstances.

The AMF proposes the application of requirements set out under MFDA rules whereby the minimum amount of insurance to be maintained must be the greater of:

- a. \$50,000 for each representative up to a maximum of \$200,000,¹¹
- b. 1% of the base amount (i.e. the greater of: a) the net value of cash and securities held by the firm on behalf of clients; and b) the total allowable assets of the firm determined in accordance with Statement A of MFDA's Form 1).

Question 4

Do you agree with this proposal? If you disagree, please explain.

5.4 Repeal of second paragraph, section 149 of SA

The AMF is considering the repeal of the second paragraph, section 149 of SA and solicits comments in this respect. In Québec, only mutual fund and scholarship plan representatives governed by the Distribution Act may also be employed by a financial institution. This option is not available to representatives of a dealer with an unrestricted practice governed by SA.

¹⁰ For details of insurance coverage, see Appendix A to draft Regulation 31-103.

¹¹ The amount is \$500,000 for a registered firm that holds client property (securities or cash) and is therefore referred to as a "Level 4" according to MFDA rules.

The AMF believes that being concurrently employed by a financial institution is a matter related to the control and monitoring carried out by the AMF at the time of the representative's registration. If potential conflicts of interest arising from the relationship between the dealer to which the representative is attached and the financial institution related to the dealer are properly managed, this activity should not be permitted for one category of representatives and denied to another.

The restriction set out in the second paragraph, section 149 of SA does not exist in other jurisdictions.

Question 5

Do you agree with such a proposal? If you disagree, please explain.

Question 6

If the second paragraph, section 149 of SA were to be repealed, how would this impact your distribution activities and structures?

6. AMF RECOGNITION OF INDUSTRY SRO

6.1 Introduction

The AMF believes the mutual fund sector must have an industry SRO for the purpose of supervising firms in accordance with Regulation 31-103.

SRO oversight is a specialized activity in a given sector, thereby enhancing the supervision of participants and improving investor protection.

Recognition of an industry SRO would take place pursuant to section 59 of the *Act respecting the Autorité des marchés financiers* ("AMF Act").

6.2 Status quo

The AMF has given consideration to the status quo, namely, maintaining the requirement for mutual fund representatives to join the CSF, without recognition in Québec of an industry SRO for firms. It has concluded that other options may be more appropriate.

6.3 Options

The AMF has identified three options regarding the recognition of an industry SRO:

1. recognition of the MFDA with exclusive jurisdiction over mutual fund firms and representatives in Québec;
2. recognition of the MFDA with exclusive jurisdiction over firms and representatives but with CSF outsourcing of functions related to representatives;
3. recognition of the CSF as industry SRO and adoption by the CSF of all MFDA rules.

6.4 Industry SRO membership fees and annual fees

The MFDA membership fee is based on the level of the mutual fund dealer and varies from \$3,000 to \$5,000. Annual membership fees are set, for the period from July 1, 2006 to July 1, 2007, at the following amounts:

- \$102 per million on the first \$500 million of assets under administration;
- \$96 per million on the next \$500 million of assets under administration;
- \$88 per million on the next \$4 billion of assets under administration;
- \$82 per million on the next \$5 billion of assets under administration;
- \$77 per million in excess of \$10 billion of assets under administration.

In the event the CSF is recognized as an industry SRO in Québec, fees payable to the CSF would be identical to fees payable to the MFDA. This hypothesis is retained since the responsibilities of CSF would be identical to the ones assumed by the MFDA in other provinces.

The appropriateness of each of the three foregoing options, which are described in more detail as follows, must be considered based on the hypothesis that membership and annual fees would be identical, irrespective of which option will be proposed to the ministère des Finances du Québec.

6.5 Option 1: recognition of MFDA in Québec

This option recognizes the MFDA as an industry SRO in Québec with exclusive jurisdiction over mutual fund firms and representatives. Under this option, the CSF would have no jurisdiction over mutual fund representatives. Under this option:

1. the registration of mutual fund dealers and their representatives would not be delegated to the MFDA and the function would continue to be performed by the AMF;
2. the inspection of mutual fund dealers would be delegated to the MFDA;
3. mutual fund dealers would be subject to the early warning system regarding regulatory capital as well as all MFDA rules;
4. the MFDA would perform all functions in respect of mutual fund representatives and this would:
 - eliminate the role of the CSF in respect of mutual fund representatives in Québec, thereby complicating the application of the multisector principle for representatives in Québec;
 - require an amendment to the *Regulation governing compulsory professional development*, which would no longer apply to mutual fund representatives in Québec.

Question 7

Do you agree with this proposal? If you disagree (excluding the matter of MFDA membership fees and annual fees), please explain.

Question 8

Other than those discussed in paragraphs 1 to 4 above, should the recognition decision contain terms and conditions?

Question 9

What would be an appropriate transition period under the circumstances?

6.6 Option 2: recognition of MFDA in Québec with CSF outsourcing

Under this option:

1. the registration of mutual fund dealers and their representatives would not be delegated to the MFDA and the function would continue to be performed by the AMF;
2. the inspection of mutual fund dealers would be delegated to the MFDA;
3. mutual fund dealers would be subject to the early warning system regarding regulatory capital as well as all MFDA rules;
4. MFDA functions in respect of mutual fund representatives would be performed in Québec by the CSF under outsourcing terms set out in the recognition decision;
5. with respect to the conduct of representatives, shared jurisdiction between the MFDA and the CSF would be based on the representative's province of residence or business location.

Question 10

Do you agree with this proposal? If you disagree (excluding the matter of MFDA membership fees and annual fees), please explain.

Question 11

Other than those discussed in paragraphs 1 to 5 above, should the recognition decision contain terms and conditions?

Question 12

What would be an appropriate transition period under the circumstances?

6.7 Option 3: recognition of CSF as industry SRO in Québec

Under the framework model proposed by the CSF, the information available to the AMF is as follows:

1. registration of mutual fund dealers and their representatives would not be delegated to the CSF and the function would continue to be performed by the AMF;
2. inspection of mutual fund dealers with a head office in Québec would be delegated to the CSF;
3. all mutual fund dealers, regardless of where their head office is located, would

be required to join the CSF if they carry on activities in Québec;

4. mutual fund dealers with operations in Québec and outside Québec would be required to join the MFDA and the CSF;

5. Québec mutual fund dealers would be subject to all MFDA rules, including with respect to the early warning system;

6. CSF's organization, mission and powers would be harmonized with those of the MFDA, and this would require substantial amendments to the Distribution Act.

Question 13

What are the benefits and inconveniences of recognizing the CSF as an industry SRO for the mutual fund sector, taking into account the fact that membership fees and annual fees would be the same as those prescribed by the MFDA?

Question 14

What would be an appropriate transition period under the circumstances?

APPENDIX B

Draft Financial Security -- Self-Regulation
(**"FSSR"**)

Implementation Plan

1. FSSR: CREATION; MISSION; POWERS

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Legal status</u></p> <p>Non-profit organization.</p>	<ul style="list-style-type: none"> • FSSR will continue the Chamber under the Securities Act, which will recognize it as SRO at the same conditions of supervision currently exercised by the AMF. • The Chamber will be dissolved, the <i>Distribution Act</i> will no longer apply to FSSR, and its Corporate Documents will govern it and its members. • Under the <i>Securities Act</i>, FSSR will continue to discharge its responsibilities as SRO in other financial security disciplines and, to that end, it will have some of the powers granted to a Chamber under the <i>Distribution Act</i>. • Unless the FSSR's Corporate Documents provide otherwise, the members of the Chamber will become members of FSSR.
<p><u>Members</u></p> <ul style="list-style-type: none"> • Representatives in individual insurance of persons, representatives in group insurance of persons, scholarship plan and investment contract representatives, and financial planners. • Group savings plan firms. 	<ul style="list-style-type: none"> • FSSR membership will be a function of the responsibilities and powers obtained at AMF's initiative for the purposes of the Securities Passport and the new Registration Regime or on request submitted to the AMF or to other CSAs on FSSR's initiative.

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Self-regulatory structure</u></p> <ul style="list-style-type: none"> • <u>Group savings plans</u>: supervision of firms (inspection, business conduct, capital adequacy, books and registers) and representatives (training, discipline). • <u>Other financial security disciplines</u>: ethics, training and discipline of representatives directly. 	<ul style="list-style-type: none"> • The rules applicable to group savings plans will be harmonized with those of the MFDA, but special status will be reserved for ongoing training, which is not compulsory at the MFDA.
<p><u>Recognition as SRO</u></p> <ul style="list-style-type: none"> • In Quebec, by a specific provision of the <i>Securities Act</i>, subject to the same powers of withdrawal of recognition and control as those currently held by the AMF with respect to the Chamber. • Depending on the delegations made to the AMF by the CSA under the Passport System, exempts recognition of FSSR by CSA if need be, subject in this case to the conclusion of a memorandum of understanding between the AMF and CSA to provide for joint supervision of FSSR. 	<ul style="list-style-type: none"> • Similar to the Montreal Exchange Inc., a market acting as an SRO recognized by the AMF but exempted from recognition by Canadian regulators in other provinces.

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Method of delegating powers</u></p> <ul style="list-style-type: none"> • Decided by the AMF and approved by government under the <i>Act respecting the AMF</i>. • Decided by the CSA in favour of the AMF under the respective CSA's organic laws and subdelegation by the AMF to FSSR, as applicable. 	
<p><u>Delegated powers (open-ended list)</u></p> <ul style="list-style-type: none"> • Establishing the rules and standards governing the members' business conduct (subject to the AMF's approval). • In partnership with the MFDA, the regulatory framework of the firms' financial stability, their internal control, capital adequacy, solvency and administration (books and registers, reports, manner in which complaints are handled, etc.). • Assessment of the compliance of members and their representatives with FSSR's Corporate Documents (or of MFDA members and their representatives for operations conducted in Quebec, via a memorandum of understanding). • Representatives' ongoing training. • Procedure to supervise the representatives' activity by the firms. • Administration of disciplinary justice (by domestic courts [contractual] established in the Corporate Documents) as regards firms and their representatives, as well as FSSR members who conduct business in other financial security disciplines. 	<ul style="list-style-type: none"> • Equivalent to the MFDA's powers, with variations to account for maintaining in FSSR the Chamber's current responsibilities with respect to other financial sectors. • The relationship of members with FSSR becomes contractual and no longer statutory, as is now the case under the <i>Distribution Act</i>.

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Delegated powers (open-ended list)</u> (cont.)</p> <ul style="list-style-type: none"> • Investigations regarding alleged breaches of FSSR regulations by firms and representatives. • Power to assess members. • Admission requirements of firms as FSSR members, requirements to establish relations between the firms and aspiring representatives, requirements to enter the profession of representative, and approval of the admission of members and entering the profession of representative. • Inspection of FSSR member firms (or the Quebec operations of MFDA members via memoranda of agreement. • Obligation to pay into a protection fund in the event of losses and insolvency of a firm, namely the MFDA's Investor Protection Corporation . 	<ul style="list-style-type: none"> • See "Funding" below.
<p><u>Funding</u></p> <ul style="list-style-type: none"> • Annual dues payable by members based on a rate set according to assets under management in the case of group savings plan firms and a lump sum in the case of representatives conducting business in other financial security disciplines. 	<ul style="list-style-type: none"> • Dues are set by the Board of Directors to recover the costs related to the expenditure budget, and to set up a contingency reserve.

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Inspections and investigations</u></p> <ul style="list-style-type: none"> • FSSR conducts inspections and investigations of its members' conduct and activities (firms and representatives). 	
<p><u>Disciplinary process</u></p> <ul style="list-style-type: none"> • FSSR determines the rules governing the creation of disciplinary committees. • In the event of any breach of a standard or rule applicable to a firm or a representative, as applicable, a disciplinary committee may impose a reprimand, a fine, a suspension, an interdiction, revoke the right to be an FSSR member or attach conditions to the authorization to carry on a business related to securities. • A decision of a disciplinary committee may be reviewed by the Securities Decision and Review Board as regards group savings plans or by an appeal to the Court of Quebec for other financial security disciplines. • The penalties and amounts having to do with settlement agreements will be determined by FSSR. 	<ul style="list-style-type: none"> • As regards discipline, the administration structure will be put in place by the FSSR's Corporate Documents and not by the Act as is now the case. • The <i>Securities Act</i> will confirm the AMF's ability to delegate certain powers related to inquiries and carrying out its decisions to the SROs, so as to allow FSSR to keep powers equivalent to those currently held by the Chamber (specifically, power to enforce the attendance of witnesses, homologation of decisions).

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Governance structure</u></p> <ul style="list-style-type: none"> • Board of directors made up of individuals elected by the members (representatives and firms) and the CEO appointed by the board. • A nomination committee established by the board will submit candidates for election, making sure to respect certain representation and expertise criteria. Other candidates may be proposed according to FSSR's regulations. • A certain number of FSSR elected directors will be independent and represent the public, and an equal number of elected directors will not be independent (related to any one of the disciplines FSSR will oversee). • The election process will provide that some independent directors and an equal number of directors who are not independent will be elected by the firms; the same number of directors who are not independent and at least this number + an independent director with the right to vote (thereby giving a majority to the independents) will be elected by the membership. • The CEO by right will be a director, but will not have the right to vote. S/he will also have to qualify as an independent director. 	<ul style="list-style-type: none"> • The terms and conditions will be provided for by regulation approved by the AMF, which could establish certain directives for their application, in the manner the other CSAs have done in their decisions to recognize the MFDA.

<u>CHARACTERISTICS OF FSSR</u>	<u>COMMENTS</u>
<p><u>Governance structure</u> (cont.)</p> <ul style="list-style-type: none"> • The term of an independent director will be 3 years; that of a director who is not will be 2. • A transitional board of directors, initially set out in the FSSR's Corporate Documents, will preside over FSSR destinies for up to 2 years at the onset. 	