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IIROC White Paper — Proposed changes to the current structure for distributing mutual funds in Canada

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On November 25, 2015, the Investment Industry Regulatory Organization of Canada (IIROC) published a White Paper for consultation. It is seeking comment on two proposals which, if approved and implemented, would change the current structure for distributing mutual funds in Canada. A "restricted practice" policy and a policy involving directed commissions are being proposed.

RESTRICTED PRACTICE POLICY

The proposal would allow an IIROC dealer member to use representatives who would not advise and would only offer mutual funds and exchange-traded funds (restricted dealing representatives). To do so, they would not have to be trained and qualified to advise or trade the other categories of securities normally offered by the dealer. An IIROC dealer member who wishes to hire restricted dealing representatives currently must ask IIROC for an exemption from the proficiency upgrade requirement for a mutual fund representative who will work for it.

The considerations described in the White Paper stem from such an exemption request. According to a survey of around forty brokerage firms, the conclusions of which are described in the White Paper, this proposal raises the issue once again of a possible merger between the Mutual Fund Dealers Association of Canada (MFDA) and IIROC. It would also harmonize the respective missions of these self-regulatory organizations (SROs) regarding the regulation of mutual fund representatives, at least those who are registered as restricted dealing representatives by IIROC.

DIRECTED COMMISSION POLICY

The proposed directed commission policy would allow an IIROC dealer member to pay commissions directly to an unregistered personal corporation controlled by a representative. This proposal is being put forward to support the restricted practice proposal since the survey mentioned above showed that "for many registered firms and individuals, eliminating the proficiency upgrade requirement on the IIROC platform is of limited interest unless directed commissions are also

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allowed".

The MFDA already allows commissions to be directed to unregistered corporations provided a written agreement is signed by the mutual fund dealer, the representative and the representative's personal corporation stating that the dealer and the representative must comply with MFDA requirements and the representative and the personal corporation must both provide the mutual fund dealer full access to their books and records.

ISSUES SPECIFIC TO QUEBEC

In Quebec, the Chambre de la sécurité financière has exclusive responsibility for self-regulating mutual fund representatives under *An Act respecting the distribution of financial products and services* (Distribution Act). This means that a new IIROC category of restricted dealing representatives would require legislative changes in Quebec to allow a mutual fund representative to only be a member of IIROC through a dealer member of that organi- zation. Such changes to the Distribution Act are unlikely in the foreseeable future, at least until the Department of Finance has completed its review of the enforcement of the Distribution Act.

We would also add to this list of conditions the approval of changes to the orders recognizing IIROC as a securities self- regulatory organization and the possible re-examination of exemptions from certain requirements of Regulation 31-103 which are granted to IIROC and MFDA dealer members. Such a re- examination would be required since such orders and exemptions are not issued based on an overlapping of the regulation of mutual fund representatives attached to these respective categories of dealers.

MFDA CONSULTATION

Further to the publication of the White Paper, the MFDA recently released the results of a consultation held with 79% of its members on the potential impacts of the application of IIROC's proposed policies. If the restricted practice policy is adopted, most MFDA member firms believe that they would either go out of business or be forced to merge with firms registered with IIROC. Such a step would only benefit MFDA member corporations that are also affiliated with an IIROC member corporation, which would allow them to reduce their operational costs, increase efficiency and be more competitive.

MFDA members generally agree that the current SRO structure adequately protects investors and that the inevitable restructuring of this system that would result from the adoption of the restricted practice policy should be aimed at protecting investors, not reducing costs. MFDA members are therefore leaning in favour of the status quo with respect to the new policies discussed in the IIROC White Paper.

The White Paper consultation will end on March 31, 2016.

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