



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels
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September 9, 2004

Attn: Mr. Ken Parker
Director, Capital Markets
Alberta Securities Commission
4th Floor, 300 – 5th Avenue S.W.
Calgary, AB T2P 3C4

Dear Mr. Parker:

Re: MFDA 2004 Oversight Audit Report

In February, 2004 the Alberta Securities Commission (“ASC”) staff performed an oversight review of the MFDA Prairie Region’s compliance department and its membership application review process. On August 13, 2004 you provided us with the 2004 Oversight Audit Report (the “Report”). We acknowledge the ASC staff’s overall conclusion that it was satisfied with the operations of the MFDA’s compliance department and with the membership application review process.

You invited our comments in response to the Report. We understand our comments will be published on the ASC website concurrently with the release of the Report. We appreciate the opportunity to comment on the Report. It underscores the cooperative relationship between the ASC and the MFDA in the interest of effective and transparent regulation.

Our comments follow. Specific sub-section and sub-heading references below are cross-referenced to those in the Report.

General

The MFDA was recognized by the ASC on April 10, 2001 and received over 250 applications for membership, primarily between May and July 2001. The provincial securities regulatory authorities established deadlines for the MFDA to successfully admit mutual fund dealers into membership. Due to these factors, the MFDA had to develop a process for admitting existing mutual fund dealer registrants across Canada and their corresponding 55,000 registered salespersons into membership on an expedited basis. Accordingly, the membership application process reviewed by ASC staff was developed to accommodate the one-time occurrence of the MFDA establishing its membership. The MFDA has recently revised its application package and application program to reflect the fact that the initial influx of applicants is past and we will now be receiving applications from new registrants on an intermittent basis.

Furthermore, the MFDA is facing the challenge of acclimatizing its membership to a self-regulatory organization (“SRO”) environment. Mutual fund dealers have not been subject to the same level of direct regulatory oversight as they are now and, in many cases, the MFDA has set higher standards than existing securities legislation. These factors have required Members to make significant changes to their operations. Changing the compliance environment within our membership is a considerable task that we are confident we are accomplishing.

Compliance Department

2.0 Examination Findings

2.1 Policies and Procedures Manual

The Report contains a finding that the MFDA does not have policies and procedures to ensure that “Reviews of Members occur at a frequency requested by the ASC.” Prior to its recognition as an SRO, the MFDA represented to the provincial securities regulatory authorities that our goal was to examine our entire membership within the first three years of becoming fully operational. While we are currently on target to reach this goal, it should be noted that this three-year objective was established without knowing the exact status of our Members’ compliance. Some Members have not been subject to a regulatory examination by either a provincial regulatory authority or to-date by the MFDA and so their current compliance status is unknown. We do agree, however, that this objective should be outlined in our existing Compliance Reference Manual.

The Report contains a finding that the MFDA does not have policies and procedures to ensure “Cooperation with the ASC in conducting reviews of its Members.” On an informal basis we have been communicating our examination schedule with ASC staff in recognition of the importance of keeping the ASC advised. We will formalize this process and incorporate it into our existing Compliance Reference Manual. Further, given our common interests in the regulation of mutual fund dealers carrying on business in Alberta, we would be pleased to conduct joint compliance examinations with ASC staff. Such initiatives would reduce the duplicative efforts and costs involved in our carrying-out our respective mandates to regulate Alberta-based mutual fund dealers.

2.2 Staffing Complement

The Report indicates that “At the time of the ASC’s 2004 oversight audit one compliance officer position was vacant...” The budgeted personnel additions for the Prairie Region office did not contemplate adding a compliance officer during the review period but rather provided for the addition subsequent to the review period. Accordingly, this position was not vacant during the review period. Also, for greater certainty, the MFDA’s staffing throughout the review period was sufficient to ensure the MFDA’s regulatory mandate was not impaired.

The Report contains a recommendation that the MFDA fill vacant positions within two months. We agree with that recommendation. We have in fact filled vacant positions, there having been only one, within that timeframe.

2.3 Benchmarks

We agree with the recommendations regarding monitoring benchmarks and the documentation and assessment of instances where benchmarks are not met in order to minimize subsequent occurrences. We would like to advise that the four benchmarks referred to in your report were not in fact formal benchmarks but guidelines for compliance staff. The MFDA did not establish formal benchmarks in 2003 as we believed it was more appropriate to wait until we had obtained sufficient experience to establish realistic and relevant national benchmarks.

The MFDA's first year of performing compliance examinations was 2003 and the timeframes cited by the ASC relate to our earliest examinations. We had new staff and a new membership, both of whom required training and education on MFDA requirements and process. Additionally, we felt it would be prudent to establish benchmarks once the MFDA had gained sufficient experience so they would be realistic and appropriate.

We note that "ASC Staff interpret completion of the examination to mean the date field work was completed" and "ASC Staff believe 7 weeks (or longer) to submit a file is unacceptable." Our views differ from those of ASC Staff. In our experience there are almost always outstanding items required from a Member at the time MFDA staff completes its field examination at the Member's premises. It is often in the best interest of effective regulation to provide the Member with a reasonable timeframe to submit the outstanding items. With this information MFDA staff can make an informed conclusion and complete the file rather than simply cite the Member for a failure to provide the item during the onsite examination and in doing so force the core issue to be clarified and resolved after the compliance examination report is issued. In our view, the completion of the examination occurs at the earlier of the Member providing such items or the expiration of Member's timeframe to do so. We have more recently compressed the timeframes for a Member to provide such items. Also, while we agree that generally "7 weeks (or longer) to submit a file is unacceptable" we submit that there are from time-to-time circumstances, typically regarding a Member's post-examination conduct, that support a delay in the completion of the file pending clarification of the Member's course of action. Such delays in completion of the file would be with the knowledge and approval of the responsible MFDA staffperson's direct supervisor.

2.4 Sample Size Policies, Methodology and Documentation

We agree with your recommendation regarding the development of policies with regard to sample selection methodology and the file documentation in support thereof.

ASC staff indicates it was "... unable to determine if sample size was representative because there was no documented information of population size." We note that neither the MFDA, nor to our knowledge any other securities regulatory body in Canada, selects and tests a statistically "representative sample" in the course of field compliance examinations.

2.5 Timely Issuance of Compliance Examination Reports

The examinations reviewed by ASC staff were amongst the first performed by the MFDA. At that time there was a significant initiative underway by MFDA compliance staff to refine and standardize the nature and wording of the compliance deficiencies cited in the MFDA's compliance examination reports to its Members. Member's compliance examination reports went through numerous revisions, including evaluations and re-evaluations of the wording. We believed that it was preferable to continue to establish and refine standards for examination reports rather than issue a work product that was not fully refined.

We believe the timeframes for issuing examination reports recommended by ASC staff are unrealistic in some cases. The MFDA examines Members on a national or multi-jurisdictional basis where applicable. The challenge of such examinations is comparable to that faced by the securities commissions in performing national compliance reviews. The national or multi-jurisdictional review process requires close co-ordination amongst regional office compliance teams. Our general guideline in conducting examinations is to perform a comprehensive examination of the head office location and three branch locations. In fact, for our larger national dealers, we have examined between four and six branch locations using different regional office examination teams. The comprehensive branch reviews performed by a regional office may be scheduled one to two weeks after the head office review, in part to allow the head office examination team to identify areas that require particular focus during the branch examination. Compliance Managers have to review the head office file and multiple branch files and co-ordinate clean-up and resolution of issues with the various examination teams. Following the Manager's final review of the file and examination report but prior to its release to the Member, the report is reviewed by the Vice-President Compliance and may be reviewed by Enforcement.

Further our examination program, including the branch examination section, is more extensive than the program in use by certain provincial regulatory authorities due to the more specific nature of MFDA Rules compared to provincial securities legislation. As a result, the MFDA examination program takes longer to perform.

Taking into account our examination experience to-date, the status of our membership and the comprehensive nature of our examination program, we recently established a benchmark of having final compliance examination reports issued to Members after the completion of fieldwork within 15 weeks 60% of the time and within 26 weeks in every instance. This compares favourably with benchmarks established by other Canadian securities regulatory authorities.

2.6 Completion of Examination Programs

We agree with the recommendation.

2.7 Evidence of Resolution

ASC staff cites one instance where a significant issue arising from a compliance examination was not followed-up by MFDA staff to ensure it was resolved. Although we do not agree with Report finding regarding the relative significance of the issue we do agree with ASC staff's recommendation. We do in fact require members to indicate the actions they will take to resolve a deficiency, including an appropriate time period for resolution. If the issue is significant, MFDA staff will take actions to ensure satisfactory resolution, up to and including performing a follow-up field examination.

Membership Application Review Process

The Membership application review processes should be viewed in two distinct phases. The initial phase, which ran from inception until early this year, was focused on the efficient appraisal of suitability for Membership of over 250 applications from existing mutual fund dealers with an aim to streamlining applicants' admittance into Membership. MFDA staff, with the concurrence of the recognizing securities commissions, performed "desk reviews" of the applicants. Applicants with critical deficiencies were not admitted to Membership until those deficiencies were resolved. Applicants with less than serious deficiencies were admitted to Membership subject to terms and conditions and/or were provided with a list of deficiencies to address after admittance to Membership. The current Membership review process is more stringent as we do not have the same volume of applications to review. The MFDA's new membership application package has been designed to solicit more complete information and the process requires on-site examinations prior to membership. We require issues to be addressed prior to membership acceptance.

4.0 Examination Findings

4.1 Policies and Procedures on the Membership Application Review Process

ASC staff note that the MFDA does not have benchmarks and completion timelines for the MFDA membership review process. In fact the MFDA has continuously monitored the timing of Membership applications to ensure that the turnaround and throughput of applications is reasonable. We find that most delays experienced during the membership acceptance process can be attributed to delays in an applicant responding to a MFDA request or resolving a deficiency. It is difficult to set a firm deadline when not all factors that affect timing of membership acceptance are within the MFDA's control.

The Report indicates, "The MFDA does not have written policies and procedures for coordinating with applicable securities commissions on applications for

exemptive relief, membership terms and conditions, and new Member applications.” We confirm that we will notify the ASC of decisions made by the MFDA in respect of Members’ applications for exemptive relief. With respect to Member terms and conditions, we expect there will be few, if any, terms and conditions placed on Members going forward. Applicants will be required to resolve all issues prior to membership. Any term and condition imposed as a result of a disciplinary action will be communicated to the provincial regulatory authorities through the Enforcement Department. Regarding new member applications, the Prairie Region has had an informal policy of advising the relevant securities commission of a new application. We will formalize this process to resolve this issue.

4.2.1 MFDA Recognition Order

The Report recommends, “The MFDA should revise the membership application review program to ensure that all approved persons are and continue to be registered with the appropriate securities commission.” Such a process would have been significantly detrimental to the timely admittance of existing dealers to Membership during the initial phase of membership application reviews. There were approximately 55,000, now 70,000, Approved Persons registered with our Members. Maintaining continuous registration information of these Approved Persons throughout the review period would require the MFDA to operate a parallel registration process to that of the provincial securities regulatory authorities and would slow the process down significantly. As we were not delegated the registration function, the MFDA has relied on the existing processes performed by the securities regulatory authorities that are directly responsible for the registration of individual Approved Persons. Also, prior to MFDA recognition, the MFDA sent a letter to the provincial securities regulatory authorities, including the ASC, to request a formal protocol for obtaining registration information. We also discussed this issue further during subsequent conference calls with CSA members. During these meetings, at the suggestion of CSA staff, we agreed that the MFDA would rely on informal processes with the securities commissions to confirm such information. Accordingly, we did so. We also rely on a requirement of membership whereby each prospective Approved Person of an applicant is required to sign an agreement to be bound by, observe and comply with the MFDA Rules, which includes a requirement that the individual be registered appropriately and in good standing.

Presently there still exist significant challenges given the MFDA does not have access to individual registrant information on the National Registration Database in Alberta. In any case, to ensure compliance by individual Approved Persons with registration requirements, on a sample basis we verify Approved Persons’ registration with the applicable securities commissions during our compliance examinations.

4.2.2 Communication with Securities Commissions

The Report recommends “The membership application review program does not direct MFDA Staff to coordinate with applicable securities commissions on applications for exemptive relief, membership terms and conditions, and new Member applications.” We would like to note that during the MFDA’s initial membership acceptance phase, we participated in quarterly, and in some instances, monthly, conference calls with CSA members where the status of the membership acceptance process was discussed in detail and status summaries were sent to the respective securities commissions. We have and continue to communicate information regarding new member applications with the relevant securities commissions. We will, however, formalize the informal process that currently exists between the Prairie Regional office and the ASC.

4.3 Timely Completion of the Application Form Review Program

The Report notes “The membership application review does not require documentation of the date started or completed, therefore, ASC Staff were unable to determine if the membership review program was completed on a timely basis.” We agree that this document does not include the date the review was started but does include a completion date. However, the start date is easily obtained by examining dates documented elsewhere in the application review file. We will ensure the membership application form review program start date is specifically documented in the file.

4.4 Resolution of Terms and Conditions

We agree that the MFDA should ensure that all Members comply with their terms and conditions. We again refer to the status of the membership during the review period. There were competing pressures on MFDA resources at the midpoint of the initial application phase. We had accepted applicants into Membership with terms and conditions and/or follow-up items for the Member’s action and had the remaining half of the applicants to admit into membership by the deadlines established by the securities regulatory authorities. We focused on accepting applicants into Membership due to the ramifications to applicants in not obtaining MFDA membership and we attempted to follow up on terms and conditions where possible. In the current phase of the Membership application process, these issues will not arise because we are requiring applicants to resolve all issues prior to membership acceptance.

We would be pleased to meet with ASC to discuss any points raised in this response letter or provide further information if required. We look forward to our continued cooperative relationship as partners in regulation. Thank you for the opportunity to respond.

Sincerely,

“Original signed by”

John L. Smeeton
Regional Director, Prairie Region