

## Chapter 13

# SROs, Marketplaces and Clearing Agencies

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### 13.1 SROs

#### 13.1.1 MFDA – Proposed Amendments to Sections 1 (Definitions) and 3 (Directors) of MFDA By-law No. 1

##### MUTUAL FUND DEALERS ASSOCIATION OF CANADA

##### PROPOSED AMENDMENTS TO SECTIONS 1 (DEFINITIONS) AND 3 (DIRECTORS) OF MFDA BY-LAW NO. 1

### I. OVERVIEW

#### A. Current By-Law

The MFDA proposes two changes to its current By-law No. 1:

- broadening the category of persons who can serve as Public Director; and
- increasing Industry Director participation on the Audit Committee.

Section 1 of the MFDA By-law No. 1 defines "Public Director". The current definition of "Public Director" disqualifies certain individuals from acting as Public Directors on the MFDA Board of Directors. These individuals include:

- (i) a director, partner, significant shareholder, officer, employee or agent of (or an associate or affiliate of): (i) a Member protection fund or of the IDA or IFIC, or (ii) a member of such fund, the IDA or IFIC;
- (ii) an employee of a federal, provincial or territorial government or Crown agency;
- (iii) a member of the House of Commons or of a provincial or territorial legislature;
- (iv) an employee of a federal, provincial or territorial Crown agency;
- (v) a provider of services to the MFDA, a Member protection fund or a Member; and
- (vi) an individual who is a member of the immediate family of an individual who would otherwise be disqualified from being a Public Director pursuant to clauses (i) to (v) above.

In addition, individuals who, within two years prior to their election as a Public Director, would have been disqualified from acting as a Public Director under clauses (i) to (iv) above are not eligible as Public Directors.

Section 3.6.2 of the MFDA By-law No. 1 currently provides that the Board of Directors shall establish an Audit Committee composed of 2 Public Directors and 1 Industry Director.

#### B. The Issues

The MFDA is of the view that the restrictions on the persons referred to in the current definition of a Public Director above are too broad and inconsistent with current governance benchmarks, required regulatory policy and the standards of other self-regulatory organizations ("SROs"). Moreover, as a practical matter, the Governance Committee of the MFDA Board of Directors, which is mandated with identifying and recommending Public Directors for election to the Board, has experienced difficulty in identifying qualified Public Directors as a result of what has been perceived as unduly restrictive qualifications for Public Directors.

The current composition of the MFDA's Audit Committee includes only one Industry Director. In the view of the Audit Committee, which is endorsed by the Governance Committee and the Board, increased participation by Industry Directors would assist the Committee in assessing the needs of the MFDA and the circumstances of its Members as firms subject to the MFDA's regulatory activities. The addition of one more Industry Director requires the addition of one more Public Director in order to maintain the desired majority of Public Directors.

### C. Objectives

The objective of the proposed amendments is to align the MFDA governance standards with current SRO practices and increase the number of qualified individuals who meet the requirements to act as Public Directors. The increase of Industry Directors on the Audit Committee will permit the Committee to be more aware of mutual fund dealer industry issues and regulatory requirements.

### D. Effect of Proposed Amendments

The proposed amendments will help to ensure that there is an appropriate pool of individuals who qualify as Public Directors and that individuals who act as Public Directors are best suited to make decisions that properly reflect the public interest. The definition of the term "Public Director" will continue to ensure that individuals appointed as Public Directors do not raise conflicts of interest or other undesirable concerns with respect to that individual's independence. The removal of the particular restrictions on qualification will not prevent the Governance Committee from applying any such restrictions in appropriate cases pursuant to their discretion under the Committee's terms of reference. In addition, the eligibility as a director of any current Public Director will not be affected by the enactment of the amendments to the By-law.

The amendments to section 3.6.2 of By-law No. 1 will ensure broader input and representation from the mutual fund industry on the Audit Committee in order to better serve the interests of Members and the public.

## II. DETAILED ANALYSIS

### A. Relevant History

The MFDA's current governance structure, including the definition of "Public Director", is the result of the "Report of the Corporate Governance Committee on a Plan for Governance by the MFDA", as adopted by the MFDA Board of Directors in February 2003 (the "2003 Report"). The corporate governance structure adopted was intended to be rigorous and "leading edge", particularly in the area of ensuring that the public interest is best served and undesirable conflicts of interest or influence do not arise. In this regard, the 2003 Report and the structure adopted were tilted to a prescriptive approach in using detailed rules rather than a principle-based approach, which preserved the objectives of the 2003 Report, but permitted some flexibility in applying the principles. This prescriptive approach is particularly apparent in the adoption of the definition of "Public Director" of the MFDA. At the same time, the 2003 Report recognized that the key to sound governance for the MFDA (as is the case with most organizations) is a robust director nomination process where a strong governance committee can identify, assess and recommend the nomination of effective directors including Public Directors with appropriate independence. The MFDA's Governance Committee has developed and operates in that manner, and the MFDA believes that its Board of Directors properly reflects the balance of the diversity of MFDA Members' interests as well as having strong independent Public Directors. The terms of reference for the Governance Committee do and will continue to reflect this mandate.

However, the experience of the MFDA's Governance Committee in identifying and assessing potential Public Directors has demonstrated that certain aspects of the criteria for Public Directors may be too rigid and inappropriate. This conclusion is not surprising in light of the fact that the 2003 Report was developed without the benefit of much MFDA Board selection experience. Moreover, the standards for general corporate governance have been subject to considerable scrutiny and change in the past few years. These kinds of changes were anticipated in the 2003 Report, as it endorsed the need for the MFDA's governance to be under regular review. The proposed amendments are a result of such review and are based on the actual experience of the MFDA's Public Director nomination process.

In February of 2008, the MFDA Board of Directors approved amendments to the MFDA By-law No. 1 relating to the definition of "Public Director" to permit individuals currently ineligible as Public Directors on the basis described above to qualify as Public Directors, where appropriate, in accordance with the MFDA's nominating procedures. These amendments (embodied in proposed By-law No. 15) were substantially the same as the proposed amendments described in this request for comments and were included with other amendments to the MFDA's governance structure as reflected in its By-laws. For a variety of reasons, the proposed amendments did not become effective following the MFDA's Annual and Special Meetings of Members in 2008 and 2009 and a review of certain matters relating to the MFDA's Member meeting practices by a Panel of the British Columbia Securities Commission. During 2009, the MFDA established a special Task Force on Governance Issues, which prepared and distributed a Report, including Member consultation. [The Report of Task Force on Governance Issues](#) endorsed the changes to the definition of "Public Director" as reflected in the By-law amendments (By-law No. 15) that had previously been recommended to Members in the Report.

The Board of Directors, on the basis of recommendations from the Governance Committee and the views of Members as expressed over the past two of years, has determined that, of the proposed amendments contained in By-law No. 15, only those relating to the definition of "Public Director" should be implemented, in addition to some minor technical drafting corrections. Accordingly, at its meeting on September 28, 2011, the Board passed the proposed amendments.

**B. Proposed Amendments**

The definition of "Public Director" in section 1 of the MFDA By-law No. 1 will be amended to remove certain restrictions on individuals that qualify as Public Directors. Specifically:

- (i) the restrictions limiting an individual who is an employee of a federal, provincial government or territorial Crown agency and members of the federal House of Commons or provincial or territorial legislative assembly will be removed;
- (ii) the two-year cooling-off period applicable to certain candidates will be removed;
- (iii) the restriction on immediate family members of individuals otherwise disqualified from being considered to be Public Directors will be narrowed; and
- (iv) providers of services for significant compensation will not be expressly excluded.

In addition, certain historical restrictions relating to persons associated with either the Investment Funds Institute of Canada or the Investment Industry Regulatory Organization of Canada ("IIROC", formerly the IDA) have been removed. Similarly, restrictions relating to persons associated with protection funds covering MFDA Members have been removed.

The proposed amendments to section 3.6.2 of By-law No. 1 will increase the number of Industry Directors on the Audit Committee from 1 to 2 to allow for broader industry input. In addition, in order to maintain the proportional representation, the number of Public Directors on the Audit Committee will be increased from 2 to 3.

**C. Issues and Alternatives Considered**

With respect to the removal of the restriction on individuals who are employees of Crown agencies, consideration was given to whether a restriction on specific Crown agencies should be maintained, such as those involved in financial services regulation. However, it is difficult to anticipate which of the many Crown agencies could have a role in financial services regulation in a matter that would affect the MFDA or its Members. As such, it was determined that, since the Governance Committee has the ability to assess whether a particular agency raises undesirable concerns with respect to the MFDA, Crown agency employees should not necessarily be prohibited from acting as Public Directors. The same basic rationale is applicable to the removal of the restriction relating to members of Parliament or a legislature. The likelihood of that circumstance arising is remote.

With respect to prohibiting immediate family members of persons otherwise disqualified from acting as Public Directors, consideration was given to maintaining the prohibition for spouses while eliminating the prohibition for other immediate family members. It was determined, however, that spouses should not be distinguished from other family members since the Governance Committee has the ability to assess whether a particular family relationship will give rise to undesirable concerns with respect to the MFDA. The MFDA believes that, in most cases, the judgment of a spouse or other immediate family member would be able to be exercised independently of the influence of another family member who might be disqualified as a Public Director. This circumstance can be distinguished from cases such as security trading restrictions, where the mutual economic interests of family members may be more difficult to separate.

With respect to the restriction of the application of the two-year cooling-off period applicable to certain potential nominees, the MFDA believes that the existence or perception of conflicts of interest is most likely to arise in respect of persons directly involved with MFDA Members, their associates and affiliates, and regulators. The fact, for instance, that an individual may have been a Crown employee immediately prior to being elected as an MFDA Public Director would not ordinarily be expected to result in an actual or perceived conflict. However, the MFDA proposes that the terms of reference of the Governance Committee refer to a general one-year cooling-off period with flexibility in some cases to extend the period.

With respect to individuals who provide goods or services to the MFDA or a Member, or who are associated with entities that do so, the definition of a prescriptive restriction applicable in all relevant circumstances is difficult to achieve and is better left to the judgment of the Governance Committee.

In the case of all selections of Public Directors, the Governance Committee, the Board and, ultimately, the Members have the opportunity to assess the circumstances of each individual and exercise discretion to ensure that appropriate selections are made. The role of the Governance Committee is to be better defined in identifying potential Public Directors. The intention of the proposed amendments is to permit better balance of prescribed restrictions and appropriate flexibility, which will allow the Governance Committee to identify and recommend as Public Directors a wider range of persons. The ability of the Governance Committee to exercise its judgment in rejecting candidates even if they meet the stated criteria is intended to be limited in order that the purpose and integrity of the Member selection process be maintained.

**D. Comparison with Similar Provisions**

Issues that relate to the proposed amendments to the definition of "Public Director" in the MFDA By-law No. 15 (identified in Section I.B above) have been considered previously by the MFDA in the 2003 Report, as well as the Recognizing Regulators and Member groups. In these reviews, the governance structures of other comparator organizations have been considered, the closest of which is IIROC. IIROC and its sponsored investor protection organization, the Canadian Investor Protection Fund ("CIPF"), have each adopted by-laws similar in effect to the proposed amendments. The history of the MFDA's development and the mutual fund dealer industry in Canada which it regulates are unique in many respects and the work of the Task Force, including its recommendations relating to the MFDA By-law, attempts to respond to the special circumstances of the MFDA.

The issues that relate to the proposed amendments on the size of the Audit Committee reflect the need for greater mutual fund dealer experience on the Committee while retaining a Public Director majority. The proposed amendments are consistent with IIROC's audit committee composition, which must include not less than 5 directors with a majority of non-industry directors.

**E. System Impact of Amendments**

It is not anticipated that there will be any systems impact on Members as a result of the proposed amendments.

**F. Best Interests of the Capital Markets**

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

**G. Public Interest Objective**

The proposed amendments are in the public interest and will permit a broader range of persons to be considered as Public Directors, thereby providing the MFDA governance process with a wider choice of potential candidates. The MFDA governance and nominating procedures allow for adequate consideration as to whether any particular individual is appropriate to serve as a Public Director. The increase in the number of the Industry Directors on the Audit Committee does not represent a change in principle and the public interest is not affected in any detrimental manner.

**III. COMMENTARY**

**A. Filing in Other Jurisdictions**

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

**B. Effectiveness**

The proposed amendments are simple and effective.

**C. Process**

The proposed amendments have been prepared in consultation with relevant departments within the MFDA. The MFDA Board of Directors approved the proposed amendments on September 28, 2011 on recommendation of the Governance Committee.

**D. Effective Date**

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

**IV. SOURCES**

MFDA By-law No. 1  
IIROC By-law No. 1  
CIPF By-law No. 1  
2003 Report of the Corporate Governance Committee and Plan for Governance by the MFDA  
June 22, 2009 MFDA Report of the Task Force on Governance Issues

**V. REQUIREMENT TO PUBLISH FOR COMMENT**

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

**The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments.** Comments should be made in writing. One copy of each comment letter should be delivered within **90** days of the publication of this notice, addressed to the attention of:

Paige Ward  
Director, Policy & Regulatory Affairs  
Mutual Fund Dealers Association of Canada  
121 King St. West, Suite 1000  
Toronto, Ontario  
M5H 3T9  
[pward@mfd.ca](mailto:pward@mfd.ca)

and one copy addressed to the attention of:

Anne Hamilton  
Senior Legal Counsel, Capital Markets Regulation Division  
British Columbia Securities Commission  
701 West Georgia Street  
P.O. Box 10142, Pacific Centre  
Vancouver, British Columbia  
V7Y 1L2  
[ahamilton@bcsc.bc.ca](mailto:ahamilton@bcsc.bc.ca)

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the MFDA website at [www.mfda.ca](http://www.mfda.ca).

Questions may be referred to:

Jason Bennett  
Corporate Secretary & Director, Regional Councils  
Mutual Fund Dealers Association of Canada  
(416) 943-7431

**SCHEDULE "A"**

**MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

On September 28, 2011, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following amendments to MFDA By-law No. 1:

**1. Definitions**

**"Associate"**, where used to indicate a relationship with any person, means:

- (a) any corporation of which such person beneficially owns, directly or indirectly, voting securities carrying more than 10 per cent of the voting rights attached to all voting securities of the corporation for the time being outstanding;
- (b) a partner of that person ~~acting on behalf of the partnership of which they are partners;~~
- (c) any trust or estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar capacity;
- (d) any relative of such person ~~who resides in the same home as that person, including his/her spouse, or his/her spouse who has the same home as such person;~~
- (e) any person who resides in the same home as the person and to whom that person is married, or with whom that person is living in a conjugal relationship outside of marriage; or
- (f) any relative of a person mentioned in clause (e) above who has the same home as such person;

~~but where the Board of Directors orders that two persons shall, or shall not, be deemed to be associates, then such order shall be determinative of their relationships in the application of By-laws, Rules and Forms, with respect to that Member;~~

**"Public Director"** means a Director who is not:

- (a) an officer (other than the Chair or a Vice-Chair) or an employee of the Corporation;
- (b) a current partner, director, officer, employee or person acting in a similar capacity of, or the holder of a Significant Interest in:
  - (i) a Member;
  - (ii) an Associate of a Member; or
  - (iii) an affiliate of a Member; or
- (c) an Associate of a partner, director, officer, employee or person acting in a similar capacity of, the holder of a Significant Interest in, a Member.
- (a) ~~who is not a current director (other than a Public Director), officer or employee of, or of an associate or affiliate of:~~
  - (i) ~~the MFDA;~~
  - (ii) ~~any protection or contingency fund in which Members (at the time the director holds the relevant office) are required to participate; or~~
  - (iii) ~~the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;~~
- (b) ~~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:~~
  - (i) ~~the MFDA;~~

- (ii) ~~any protection or contingency fund in which Members (at the time the director holds the relevant office) are required to participate; or~~
- (iii) ~~the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;~~
- (c) ~~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;~~
- (d) ~~who is not a current member of the federal House of Commons or member of a provincial or territorial legislative assembly;~~
- (e) ~~who has not, in the two years prior to election as a Public Director, held a position described in (a)-(d) above;~~
- (f) ~~who is not:~~
  - (i) ~~an individual who provides goods or services to and receives direct significant compensation from, or~~
  - (ii) ~~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~~
- (g) ~~who is not a member of the immediate family of the persons listed in (a)-(f) above.~~

For the purposes of this definition:

- (i) ~~"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;~~
- (ii) ~~"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.~~

**"Significant Interest"** means in respect of any person the holding, directly or indirectly, of the securities of such person carrying in aggregate 10% or more of the voting rights attached to all of the person's outstanding voting securities.

### 3. Directors

#### 3.2 Composition of the Board of Directors

The Board of Directors shall be composed of 6 Public Directors, 6 Industry Directors and the President and Chief Executive Officer. The members of the Board of Directors (other than the President and Chief Executive Officer) shall collectively and over time be nominated and elected on the basis that there will be timely and appropriate regional representation on the Board of Directors of Members of the Corporation across Canada, provided that at any time (subject to the occurrence of vacancies) not less than 4 of the directors shall represent regions other than the Provinces of Ontario and Quebec. In addition, at any time (subject to the occurrence of vacancies) five of the Industry Directors shall be officers or employees of a Member of the Corporation or of an affiliate or ~~associated corporation~~ which is an Associate of a Member. No Member, affiliate or ~~associated corporation~~ which is an Associate of a Member shall have more than 1 director, officer, employee or other representative on the Board of Directors and, if such event should occur, the Board of Directors in its discretion may request the resignation of or remove as a director, any director or directors in order that the requirements of this section are satisfied. Each director shall be at least 18 years of age.

#### 3.6 Committees

##### 3.6.1 Governance Committee

The Board of Directors shall establish a Governance Committee composed of 2 Public Directors and 2 Industry Directors. The 2 Industry Director members of the Governance Committee shall be officers or employees of a Member of the Corporation or of an affiliate or ~~associated corporation~~ which is an Associate of a Member. The Chair of the Governance

Committee shall be 1 of the 2 Public Directors as selected by the Board of Directors. The Governance Committee shall be responsible for identifying and recommending to the Board of Directors Public and Industry Directors for election to the Board of Directors in accordance with the By-laws and the terms of reference adopted for the Governance Committee by the Board of Directors. In addition, the Governance Committee shall perform such other duties as the Board of Directors may delegate or direct from time to time. 1 Public Director and 1 Industry Director shall constitute a quorum of the Governance Committee.

3.6.2 *Audit Committee*

The Board of Directors shall establish an Audit Committee composed of 2-3 Public Directors and 1-2 Industry Directors. The Chair of the Audit Committee shall be 1 of the 2-3 Public Directors as selected by the Board of Directors. The Audit Committee shall review and report to the Board of Directors on the annual financial statements of the Corporation and shall perform such other duties as the Board of Directors may delegate or direct from time to time. 1-2 Public Directors and 1 Industry Director shall constitute a quorum of the Audit Committee.