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MFDA ANNOUNCES NEW PROFICIENCY STANDARDS FOR SELLING ETFS

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Introduction

On July 20, 2017, the Mutual Fund Dealers Association (the "**MFDA**") announced the regulatory approval and coming into effect of its new *Policy No. 8 – Proficiency Standard for Approved Persons Selling Exchange Traded Funds* ("**ETFs**") (the "**Policy**").[]] The Policy outlines new minimum training and educational requirements for a member of the MFDA ("Member") or an Approved Person[2] dealing with an exchange traded fund ("**ETF**"). The goal of the Policy is to ensure compliance with MFDA Rule 1.2.3 (Education, Training and Experience) and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Obligations* ("**NI 31-103**").

The Policy

While MFDA Members and Approved Persons may sell ETFs that meet the definition of a mutual fund, there are important differences between ETFs and conventional mutual funds. For example, conventional mutual funds are traded as a primary distribution with the issuer, while ETFs are mutual funds that are traded in the secondary market on an exchange. Given the differences, the MFDA stated that existing courses and examinations used satisfy proficiency requirements under NI 31-103 in respect of the sale of conventional mutual funds do not sufficiently cover the sale of ETFs, with the exception of the Canadian Securities Course. In response, the MFDA has adopted the Policy which requires Approved Persons to be trained in a variety of essential subjects relating to ETFs.

Generally, the MFDA emphasizes that training must address the particular qualities of ETFs and their differences from conventional mutual funds. In this regard, the MFDA has established a detailed training program that addresses existing mutual fund-related and new ETF-specific topics. This includes an allocation scheme that lays out the MFDA's training priorities. According to this scheme, 15% of training must be allocated to introductory ETF material, 10% to ETF regulation, 20% to ETF's characteristics, 15% to ETF investing, and most substantially, 40% to exchange trading.

As part of the Policy, the current training topics must be tailored to address the specific context of ETFs and



distinguish them from conventional mutual funds. These include:

- introductory material regarding relevant regulations, such as offering documents and disclosure requirements;
- general characteristics of ETFs, such as operating costs, their benefits and relevant risks;
- exchange trading generally, including an introduction to financial markets; and
- general investing subjects relevant to ETFs, such as taxation, know-your-client rules and related obligations.

New topics that ETF training must address include:

- introductory material relating to ETFs, including Dealing Representatives' registration requirements and limitations on what types of ETFs may be sold;
- specific characteristics of ETFs, including the creation and redemption of ETF units;
- exchange trading in ETFs, including pricing and quoting ETFs and order processes; and
- ETF-specific investing, especially portfolio management.

Approved Persons may obtain this training through a Member or through an independent provider. The MFDA has stated that the following independent courses will satisfy the new ETF proficiency standard:

- Canadian Securities Institute's "Exchange Traded Funds for Mutual Fund Representatives"
- IFSE Institute's "The Exchange Traded Funds Course"; and
- Smarten Up Institute's "Exchange Traded Funds for Representatives of Mutual Fund Dealers".

Where the Member provides the training, it must include the successful completion of an examination and records of the training must be kept pursuant to MFDA Rule 5 (Books, Records and Reporting).

Approved Persons must also receive specific training on the Member's policies and procedures for dealing with ETFs. This training should include a detailed explanation of the specific ETFs that the Member offers for sale, how those ETFs will be offered and how trades will be executed through the Member.

Additionally, the Policy assigns responsibility for compliance to Members rather than Approved Persons. Members are responsible for ensuring that each Approved Person has the requisite proficiency, education and training necessary to sell ETFs. The Policy also makes Members responsible for maintaining appropriate policies regarding the sale of ETFs and requires that they conduct due diligence on ETFs prior to approving them for sale to determine if they meet the definition of a mutual fund.

Conclusion



The timing of the new Policy should come as no surprise given the growth that has taken place in the Canadian ETF market. Between April 2016 and June 2017, the ETF market grew from 10 providers managing \$97 billion in assets to 24 providers managing \$130 billion and recent additions include some of Canada's largest asset managers.[3]

The MFDA's new Policy clarifies the standards that will be applied in measuring the proficiency, education and training of Members and Approved Persons dealing in these ETFs. While the MFDA's new training regime is substantively based on existing programs, there are novel elements and Members who train their own Approved Persons should pay careful attention when developing their training programs to ensure that they meet the requirements of the Policy.

It is also worth noting that further changes to the MFDA proficiency standards may be forthcoming. With the Canadian Securities Administrators' publishing the proposed regulatory framework for alternative funds[4], it is reasonable to expect the MFDA to establish additional proficiency standards relevant to the distribution of alternative funds once the anticipated amendments come into force.

by Jason Chertin, Laura Fraser and Graham Bevans, Summer Law Student

 Mutual Fund Dealers Association of Canada, Bulletin, #0726-P, "Approval of New MFDA Policy No. 8 – Proficiency Standard for Approved Persons Selling Exchange Traded Funds ("ETFs")" (July 20, 2017).
 An "Approved Person" is an individual who is a partner, director, officer, manager, employee or agent of the Member who is either registered or permitted by a relevant securities commission or submits to the jurisdiction of the MFDA. Mutual Fund Dealers Association of Canada, By-Law No. 1 (Amended and Consolidated to September 29, 2014), s 1.

[3] Clare O'Hara, "Canada's largest mutual-fund firms turn to ETFs", The Globe and Mail (9 June 2017), online: < beta.theglobeandmail.com/globe-investor/funds-and-etfs/mutual-fund-firms-turn-to-etfs/article35265252/>.
[4] Canadian Securities Administrators, "CSA Notice and Request for Comment – Modernization of Investment Fund Product Regulation – Alternative Funds" (2016) 39 OSCB 8051.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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