



THE INVESTMENT  
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OF CANADA

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D'INVESTISSEMENT  
DU CANADA



Federation of Mutual Fund Dealers  
Fédération des courtiers en fonds mutuels

February 7, 2020

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Dear Sirs/Mesdames

## **RE: Proficiency Requirements for MFDA Approved Persons to Distribute Alternative Mutual Funds**

The Investment Funds Institute of Canada (**IFIC**) and the Federation of Mutual Fund Dealers (collectively, **we**) are writing on behalf of our members to encourage the Mutual Fund Dealers Association of Canada (**MFDA**) to introduce appropriate proficiency requirements for MFDA Approved Persons to distribute securities of alternative mutual funds. Our members are committed to the proficiency and professionalism of MFDA Approved Persons in order to help support the investment goals of their clients. To assist the MFDA in this regard, we offer our suggestions within this letter.

The CSA introduced the alternative mutual funds framework to provide investors with a wider array of investment choices to help them reach their investment goals. In adopting rule amendments to establish a regulatory framework for alternative mutual funds, the Canadian Securities Administrators (**CSA**) decided to retain the proficiency standards for mutual fund dealers distributing commodity pools found in Part 4 of National Instrument 81-104 *Alternative Mutual Funds (NI 81-104)*. The accompanying notice indicated that this decision was in recognition of the increased complexity associated with alternative mutual funds, which may require more robust proficiency standards. At the time, the CSA indicated this was an interim measure while it completed broader work on dealer-focused issues. Unfortunately, the additional proficiency requirements set out in NI 81-104 for MFDA Approved Persons and for individuals supervising trades in alternative mutual funds have proven to be a barrier for many mutual fund dealers and their Approved Persons to access alternative mutual funds for their clients. As a result, the regulatory objective of providing investors with access to a broader range of investment options is not being achieved.

### **Current Proficiency Requirements**

Under Section 4.1 of NI 81-104, in the absence of any other proficiency standards established by the MFDA for mutual fund restricted individuals and firms to trade in alternative mutual funds, an MFDA Approved Person must have successfully completed the Canadian Securities Course (**CSC**), the Derivatives Fundamentals Course or the Chartered Financial Analyst Program (**CFA Program**).

In order to be registered, we believe the majority of MFDA Approved Persons successfully complete either the Canadian Investment Funds Course Exam administered by the IFSE Institute (**IFSE**) or the Investment Funds in Canada Course Exam administered by CSI Global Education Inc. (**CSI**). As a result, many MFDA Approved Persons are unable to distribute alternative mutual funds either because they do not have the proficiency required by NI 81-104 or because the individual responsible for supervising them has not completed the requirements set out in NI 81-104 for supervisors (i.e. the CFA Program or Derivatives Fundamentals Course).

In contrast, IIROC registered representatives are able to sell alternative mutual funds by virtue of their existing proficiency requirements which include the CSC. We believe this creates an unnecessary regulatory burden on MFDA Approved Persons who, instead of focusing on the actual proficiency

required to distribute an alternative mutual fund, are subject to the proficiency requirements for an individual registrant who has access to a much broader suite of investment products.

### Proposed Proficiency Requirements

When the CSA proposed NI 81-104 in June 1997, it reformulated, on a national basis, Ontario Securities Commission Policy 11.4 *Commodity Pool Programs*. The proposed proficiency requirements reflected the CSA's primary concern with the understanding and knowledge of sales representatives and their supervisors concerning commodities markets and derivatives strategies. We submit that the current discussion regarding proficiency to distribute alternative mutual funds should similarly focus on an MFDA registrant's understanding and knowledge of the alternative mutual fund product and associated investment strategies.

We recommend that the MFDA work with course providers such as IFSE and CSI to introduce a bridging course for existing registrants that addresses key elements of the alternative mutual fund product and associated investment strategies. Registrants must successfully complete an exam based on this course material.

This bridging course must be based on an assessment of the material in the existing IFSE and CSI investment funds courses against the material in the CSC to identify content related to alternative mutual funds that is not currently covered. We also note in this regard that the IFSE Exempt Market Proficiency Course, for example, today includes information on hedge funds, which capture topics related to investment strategies, risks, and uses of hedge funds, which may be equally applicable to alternative mutual funds.

The material in the bridging should be incorporated into the Canadian Investment Funds Course or the Investment Funds in Canada Course for those individuals seeking to become registrants.

We recommend that the proficiency requirements for supervisors be the same as for MFDA Approved Persons, including the requirement to successfully complete the exam based on the course materials.

We believe the bridging course should address the following topic areas:

1. Similarities between conventional mutual funds and alternative mutual funds
2. Differences between conventional mutual funds and alternative mutual funds and any additional risks associated with these differences, including:
  - Types of alternative assets invested in by alternative mutual funds, including precious metals and other physical commodities
  - Types of alternative strategies employed by alternative mutual funds, including long/short equity, long/short credit, market neutral, managed future strategies, macro strategies, and volatility strategies
  - The different investment restrictions applicable to alternative investment funds, such as:
    - Higher concentration and short-selling limits
    - Ability to employ leverage (up to 300%) for investment purposes through cash borrowing, short-selling and specified derivatives
    - Broader ability to use derivatives for hedging and non-hedging without the stringent cash cover or collateral requirements applicable to conventional mutual funds
    - Ability of alternative mutual funds to create fund of fund structures that incorporate mutual funds, ETFs and closed end funds without limit
  - Longer time period to pay redemption proceeds
  - Use of performance fees
3. Due diligence considerations for retail investment advisors

4. The role of alternative mutual funds in portfolio construction for retail clients, including the potential risks and benefits
5. CIFSC classification categories for alternative investment funds

### Conclusion

We are pleased to have this opportunity to present our suggestions for the proficiency requirements for MFDA Approved Persons to trade in alternative mutual funds. We look forward to working with you to finalize the requirements. For further information, please feel free to contact any of the undersigned.

Yours sincerely,



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