New Single SRO and Protection Fund for year-end 2022 – status and next steps

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Since 2019, the Canadian Securities Administrators (CSA) have worked towards enhancing the framework for self-regulatory organizations in Canada. Earlier this year, the CSA announced its plans to create a new, single self-regulatory organization (the New SRO) that will provide enhanced regulation of the investment industry. In tandem with creating the New SRO, the CSA is also working towards creating a new Investor Protection Fund (the New IPF).

The New SRO will consolidate the functions of the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA), while the New IPF will combine the two existing investor protection funds – the Canadian Investor Protection Fund (CIPF) and the MFDA Investor Protection Corporation (MFDA IPC) – into an integrated fund independent of the New SRO.

Both the New SRO and the New IPF are to be created by the end of 2022. These are important developments for all in the investment industry and this article outlines the key takeaways in 2022, along with the status of the CSA's work and the expected outcomes. This article is the first of a series outlining the implications of this significant regulatory initiative for the Canadian investment industry.

Application for recognition of new self-regulatory organization

On May 12, 2022, the CSA published for comment Staff Notice and Request for Comment 25-304 *Application for Recognition of New Self-Regulatory Organization* advancing its recommendation to consolidate IIROC and the MFDA into the New SRO. This staff notice built on the 2021 CSA Position Paper 25-404 *New Self-Regulatory Organization Framework*.

Subject to the CSA's consideration of the comments received on the staff notice, the New SRO can be expected to have a mandate to act in the public interest by protecting

investors from unfair, improper, or fraudulent practices by its members and fostering fair and efficient capital markets and public confidence in capital markets. The mandate will also include facilitating investor education; administering a fair, consistent and proportionate continuing education program; incorporating regional considerations and interests from across Canada; and administering robust compliance, enforcement and complaint handling and resolution processes.

The staff notice consisted of a draft application for recognition of the New SRO and included a draft by-law and interim rules, draft terms of reference for the New SRO Investor Advisory Panel, and new requirements for Québec. Also included with the staff notice was a draft Recognition Order for the New SRO, as well as a draft MOU among regulators regarding oversight of the New SRO.

The New SRO will initially have two classes of members: Dealer Members and Marketplace Members (together, the Members). Dealer Members will consist of investment dealers and mutual fund dealers, while Marketplace Members will include recognized exchanges, quotation and trade reporting systems, and others that facilitate the trading of securities or derivatives in Canada in the circumstances listed in the application.

The staff notice also set out the proposed governance structure for the New SRO. The initial board, which was announced by the CSA on May 12, 2022, consists of 15 persons, including the Chief Executive Officer of the New SRO, Andrew Kriegler (announced in June). Eight of the board members are independent and six of the board members represent the Members. The board and its committees are required to be composed of a majority of independent directors, each with independent chairs, with the Governance Committee being composed of all independent directors.

The New SRO will also have a National Council and seven Regional Councils, comprised of Dealer Members from each region, as defined in the by-law. The Regional Councils will have an advisory role and provide regional perspectives and recommendations on policy matters to staff of the New SRO. The National Council will be comprised of the chairs and vice-chairs of the Regional Councils and will act as a forum for consultations among the Councils, as well as provide recommendations on regulatory policy matters to the CEO and Chair. An Appointments Committee will have the responsibility for appointing members to the hearing committees of the New SRO.

The New SRO will establish investor engagement mechanisms, including an investor office to provide investor outreach and education and an Investor Advisory Panel to provide independent research on regulatory and public interest matters. The Chair of the Investor Advisory Panel must meet with the New SRO board at least once per year and will publish a public report annually to be posted on the New SRO's website.

The New SRO will develop an appropriate fee model following its creation. On an interim basis, the New SRO will maintain the existing fee structures and models of IIROC and the MFDA, as well as the existing criteria for access to membership and the provision of regulatory services.

All current members of the MFDA and of IIROC will become Members of the New SRO automatically once the New SRO is established and recognized by the CSA. The New

SRO intends to adopt interim rules, which will incorporate the regulatory requirements of IIROC and the MFDA and will include:

- the Investment Dealer and Partially Consolidated Rules (largely the former IIROC Rules with amendments to accommodate mutual fund dealer activity within an investment dealer);
- the Universal Market Integrity Rules; and
- the Mutual Fund Dealer Rules.

The interim rules will include new proposals to:

- amend the current IIROC proficiency requirements to allow dual registered firms to employ mutual fund-only licensed persons without having to upgrade their proficiencies to those required of a securities licensed person, although the CPH exam must completed within a specified time frame, and
- permit introducing/carrying broker arrangements between mutual fund dealers and investment dealers.

Continuing education (CE) requirements for current IIROC and MFDA registrants outside of Québec will continue to apply. Mutual fund registrants in Québec will continue to comply with the Chambre de la sécurité financière's (CSF) CE requirements. The New SRO can be expected to work towards a future harmonization of the CE program.

The staff notice also contains Requirements for Québec, including, among other requirements, that the New SRO will maintain a Québec District and any decision concerning the supervision of its self-regulatory activities shall be made principally by persons residing in Québec.

Application for approval of the new investor protection fund

Concurrently with the application to recognize the New SRO, the CSA published for comment CSA Staff Notice 25-305 *Application for Approval of the New Investor Protection Fund*. This staff notice sets out a proposal to amalgamate the two existing compensation funds - CIPF and the MFDA IPC - into a single compensation fund (the New IPF).

The New IPF will be independent from the New SRO and will be amalgamated under the *Canada Not-for-profit Corporations Act*. The purpose of the New IPF will be to provide protection to customers of New SRO Members who have suffered financial loss as a result of a Member's insolvency.

The staff notice included draft versions of the by-law, coverage policy, claims procedures, and appeal committee guidelines, along with the draft approval order for the New IPF and a draft MOU among regulators regarding oversight of the New IPF.

The New IPF is expected to be established by Dec. 31, 2022. Members of the New IPF will be the individuals who compose the board, from time to time, and they are required to meet at least annually. The primary role of members is to elect directors, appoint the

auditor of the New IPF, receive the financial statements of the New IPF, and confirm by-laws.

The staff notice sets out the proposed structure for the New IPF. The board will be comprised of industry directors and public directors, as defined in the application, and the CEO. The number of public directors must exceed the number of industry directors by at least one. The board will also appoint various committees, each of which must be comprised of a majority of public directors. The Chair of the board of the New IPF, along with industry and independent board members, was announced along with the publication of the staff notice. The CEO of the New IPF remains to be announced.

Requirements for funding and maintenance of the New IPF are also set out in the staff notice. The New IPF will be required to publish its methodologies of establishing assessments for contributions from each category of member. It will also be required to conduct analysis of the risks associated with each category to determine whether a single assessment methodology is appropriate. Until the analysis is completed, the staff notice proposes that the funds available to satisfy potential claims for coverage by customers of investment dealers and mutual fund dealers will remain segregated and be subject to separate assessments. Single entities with investment dealer and mutual fund dealer registration will have coverage from the investment dealer fund. The New IPF must ensure a moratorium on any changes to the current assessment methodologies that would result in a material increase to the assessments levied on each category of member. The money in each fund must be invested in accordance with the relevant policies applicable to that fund and require safety of principal and a reasonable income while assuring sufficient liquidity for potential claims. The draft coverage policy sets out the losses and property covered, eligible customers, and how claims can be made.

As with the proposal for the New SRO, a separate regime is proposed for customers of mutual fund dealers in Québec, considering that there is an existing regulatory framework for such dealers and that they are not currently members of the MFDA. The staff notice proposes that the New IPF will not provide coverage for mutual fund dealer customer accounts in Québec and members of the New SRO will not be subject to assessments to contribute to the Mutual Fund Dealer Fund of the New IPF in relation to mutual fund dealer customer accounts located in Québec. The AMF has published for comment its proposed transition plan for mutual fund dealers, as described in more detail below.

Amendments relating to the transition for Québec mutual fund dealers to the New SRO

The AMF published its draft Regulation to amend Regulation 31-103 respecting *Registration Requirements, Exemptions and Ongoing Registrant Obligations* to provide the transitional provisions designed to ensure that mutual fund dealers registered in Québec become members of the New SRO. Under the proposed regulation, all mutual fund dealers in Québec will be required to become members of the New SRO; however, they will be transitioned to the New SRO in two phases – a transition phase and a permanent phase – on various terms and conditions.

The transition phase will begin on Jan. 1, 2023, where mutual fund dealers in Québec will become members of the New SRO. At this time, these dealers will not be subject to the rules of the New SRO, except for its operating rules. Instead, Québec-based mutual fund dealers will continue to be subject to the regulatory framework currently applicable in Québec. Such dealers will still be able to participate in the New SRO's committees and will pay a reduced membership fee.

The permanent phase will begin on the later of the implementation date of the New SRO's harmonized rulebook, and the date that is one year after AMF approval of the New SRO's harmonized rule book or on any other date determined by the AMF, on a consultative basis. At that date, Québec mutual fund dealers would be subject to the same oversight as in the other Canadian jurisdictions, while taking into account features specific to the framework applicable to the mutual fund sector in Québec. The AMF expects the transition period to extend at least one year following the adoption of the New SRO's harmonized rulebook.

The AMF plans to consult with market participants again after Jan. 1, 2023 in respect of the amendments to National Instrument 31-103 (as it applies in Québec) that will be needed to implement the applicable model during the permanent phase.

Next Steps

There is still a lot to be determined about the implications of the New SRO and the New IPF. Both IIROC and the MFDA have published identical FAQs on their websites that essentially explain, at least for the short term, that it will be business as usual for the members of these SROs, but with opportunity for enhancements to businesses operated by MFDA and IIROC member firms, particularly for those organizations with firms that are today registered as mutual fund dealers and as investment dealers.

- IIROC - New SRO Interim Rules – Frequently Asked Questions
- IIROC - New SRO Investor Advisory Panel – Questions & Answers
- MFDA - New Draft SRO Interim Rules – Frequently Asked Questions
- MFDA - New SRO Investor Advisory Panel - Questions & Answers

If you would like to discuss how these developments might affect your business and operations, please contact your usual lawyer in BLG's Investment Management Group or AUM Law, or the authors/key contacts listed below.

We will publish further analysis and details of the developments in the coming months as further clarity become available.

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