

**Decision of the Alberta Securities Commission (Commission)**

**Pewter Financial Ltd.**

**Appeal under Sections 35 and 36 of the Securities Act (RSA 2000, c. S-4) (the Act)  
of the Decision of the Executive Director under S.76(3) of the Act**

**Panel:** Glenda A. Campbell, Q.C., Vice-Chair  
Stephen R. Murison, Vice-Chair

**Appearing:** Keith R. Odegard, C.A.  
For Pewter Financial Ltd.

Terry Hutcheon  
For Commission Staff (Staff)

**Date of Appeal:** April 30, 2003

**Date of Decision:** July 7, 2003

## **Introduction**

1. This is an appeal, under sections 35(1) and 36 of the Act, of the February 25, 2003 decision of the Executive Director refusing an application by Pewter Financial Ltd. (Pewter) to renew or amend its registration as a mutual fund dealer under the Act.

## **Background**

### ***Registration History***

2. Pewter has been registered as a mutual fund dealer under the Act since February 5, 1983.

3. In May 2002 Pewter applied under section 213 of the Act to be exempted from the requirement under section 16 of the Alberta Securities Commission Rules (General) (the Rules) to become a member of a recognized self-regulatory organization (SRO), specifically the Mutual Fund Dealers Association (MFDA). In reply to the application, Commission staff advised Pewter that the matter would be more appropriately dealt with in connection with an application to renew its registration. In December 2002 Pewter filed its application to renew its registration as a mutual fund dealer. On December 16, 2002 staff notified Pewter that its registration as a mutual fund dealer would not be renewed because it was not a member of the MFDA and had not applied for MFDA membership. On the same day Pewter requested a hearing before the Executive Director under section 76(3) of the Act.

### ***Hearing Before the Executive Director***

4. On February 21, 2003 a hearing under section 76(3) of the Act was held before the Executive Director to determine whether Pewter's registration as a mutual fund dealer should be renewed or amended. The Executive Director considered written and verbal submissions provided by staff and by Pewter.

5. The Executive Director characterized Pewter's application as, in effect, an application for exemption from the requirement for MFDA membership.

6. Pewter argued that the MFDA was not an SRO within the meaning of the Act, on the ground that it is not properly constituted. Pewter's reasoning was that the MFDA does not represent mutual fund dealers, being controlled at present by the Investment Dealers Association (IDA) and the Investment Funds Institute of Canada (IFIC), organizations whose members' interests -- full-service investment dealers and mutual fund managers or suppliers, respectively -- may differ from those of mutual fund dealers.

7. Pewter pointed out that certain other mutual fund dealers had been granted exemption from the MFDA membership requirement and argued that Pewter should be granted a similar exemption. Pewter also suggested that its registration be made subject

to certain conditions that would sufficiently protect the investing public to obviate the need for MFDA membership.

8. Staff founded their position on section 16(c)(ii) of the Rules, which requires every dealer to be a member of an SRO -- the MFDA, in the case of a mutual fund dealer. An agreed statement of facts noted that the MFDA was recognized by the Commission as an SRO in April 2001 and that section 16 of the Rules was amended effective May 1, 2001 to require SRO membership for mutual fund dealers. The agreed statement of facts noted that these measures followed a process of publication and consultation. Staff argued that the composition, nature and function of the MFDA or the validity of its recognition as an SRO by the Commission were not issues properly before the Executive Director.

9. The Executive Director found that Pewter's argument that the MFDA was not an SRO, or was not the proper SRO for mutual fund dealers, constituted in effect either an application for an exemption under section 213 of the Act from the requirements of Rule 16(c)(ii) of the Act or an appeal of the Commission's decision to recognize the MFDA as an SRO under section 64 of the Act. He noted that an application under section 213 is a matter to be decided by the Commission rather than the Executive Director. He also found that he could not hear an appeal of the Commission's decision to recognize the MFDA as an SRO under the Act because section 38 of the Act provides for appeals of a Commission decision to the Court of Appeal in accordance with the procedures set out under that section. He concluded that it would be improper for him to do indirectly, by treating the application as one for registration on terms and conditions under section 76 of the Act, what sections 213 and 38 contemplate being considered directly by either the Commission or the Court of Appeal.

10. The Executive Director differentiated Pewter's situation from that of the other mutual fund dealers that the Commission had exempted from the requirement to join the MFDA. Those other dealers, he found (indicating that Pewter had acknowledged the distinction), were not selling mutual funds to the public, but instead made incidental mutual fund sales to management, employees and their families.

11. In respect of alternative conditions of registration suggested by Pewter, staff had argued that they were insufficient, and in the course of the hearing the Executive Director expressed the view that it would not be efficient to, in effect, construct a parallel regulatory regime for any particular mutual fund dealer.

12. Staff also submitted that the conditions of registration suggested by Pewter as an alternative to MFDA membership did not address the broader policy considerations taken into account by the Commission in its decision to recognize the MFDA as an SRO under the Act. In particular, the conditions of registration proposed by Pewter did not address certain integral functions such as compliance and enforcement that are carried out by the MFDA.

13. For these reasons, the Executive Director denied Pewter's application to renew or amend its registration under the Act as a mutual fund dealer.

### **Issues**

14. The panel must consider two primary issues:

1. Did the Executive Director err in denying Pewter's application to renew or amend its registration under the Act?
2. Should the Commission exempt Pewter under section 213 of the Act, on conditions, from the requirement under section 16(c)(ii) of the Rules that every mutual fund dealer be a member of an SRO, in this case the MFDA?

### **Analysis**

#### *Legislation*

15. Section 35 of the Act permits a person directly affected by a decision of the Executive Director to appeal that decision to the Commission. Pursuant to section 36, such an appeal is conducted as an appeal on the record of the proceedings below and not as a new hearing. Section 36(3) provides that, on appeal, the Commission may make any decision that the Executive Director made, confirm, vary or reject the decision under appeal or direct the Executive Director to re-hear the matter.

16. The Executive Director's decision was made under section 76 of the Act, which states:

- (1) Unless it appears to the Executive Director that
  - (a) an applicant is not suitable for registration, renewal of registration, reinstatement of registration or amendment of registration, or
  - (b) the proposed registration, renewal of registration, reinstatement of registration or amendment of registration is objectionable,the Executive Director shall grant to the applicant the registration, renewal of registration, reinstatement of registration or amendment of registration being applied for.
- (2) The Executive Director, in granting registration, renewal of registration, reinstatement of registration or amendment to registration, may do one or more of the following:
  - (a) restrict a registration of an applicant by imposing terms and conditions on the registration;
  - (b) restrict the duration of a registration of an applicant;
  - (c) restrict the registration of an applicant to trades in certain securities or exchange contracts or a certain class of securities or exchange contracts.

- (3) The Executive Director shall not refuse to grant, renew, reinstate or amend registration for an applicant or impose terms and conditions on it, without giving the applicant an opportunity to have a hearing before the Executive Director.

17. Section 75 of the Act requires, for an entity such as Pewter to trade in securities in Alberta, that it be registered with the Executive Director as a dealer. Section 16 of the Rules elaborates on the registration requirement. It requires that every registrant who is a dealer be classified into at least one of three listed categories. For Pewter, given its business of trading exclusively in mutual funds, the appropriate category would be that of “mutual fund dealer”, for which section 16(c)(ii) sets out two elements:

- First, registration as a mutual fund dealer is restricted to the purpose of trading in shares or units of mutual funds.
- Second, a mutual fund dealer must be a member of an SRO or exchange.

18. On April 10, 2001 the Commission issued an order recognizing the MFDA as an SRO under section 53.1(1) (now section 64) of the Act on specified conditions. (As noted in the agreed statement of facts before the Executive Director, section 16 of the Rules was amended effective May 1, 2001.)

19. It was not suggested to us that an exchange or any SRO other than the MFDA is the appropriate SRO for mutual fund dealers under section 16(c)(ii) of the Rules.

20. Section 38 of the Act provides for appeals of Commission decisions to the Court of Appeal.

#### ***Interim Registration of Pewter***

21. Pursuant to the decision of the Executive Director, Pewter's registration as a mutual fund dealer has been extended on an interim basis in order to permit it to appeal that decision.

22. Pewter has not become a member of the MFDA.

#### ***Did the Executive Director err in denying Pewter's application to renew or amend its registration under the Act?***

23. The primary task of the Executive Director was to apply section 76 of the Act. As such, in assessing whether he erred in performing that task, we need to determine whether Pewter's lack of membership in an SRO or exchange, as called for by section 16(c)(ii) of the Rules, indicated unsuitability for registration as a mutual fund dealer or indicated that such registration would be objectionable.

24. In our view the answer is "yes". SRO or exchange membership -- in this case, membership in the MFDA -- is of sufficient importance to the regulation of mutual fund

dealers that its absence, without compelling circumstances supporting a different conclusion, demonstrates unsuitability for registration or renders registration objectionable.

25. There is no question that Pewter is in the full-time business of selling mutual funds to the public. Section 16(c)(ii) of the Rules is clear that to be categorized as a mutual fund dealer under section 75 of the Act, an applicant that seeks registration as a mutual fund dealer must be member of either an SRO or an exchange. The Commission recognized the MFDA to serve that purpose in April 2001.

26. Pewter based its argument on the premise that the MFDA is not an SRO, or is not the proper SRO for mutual fund dealers. In effect, Pewter argues that the Commission erred in recognizing the MFDA for the purpose of section 16(c)(ii) of the Rules. However, an appeal from that decision of the Commission could not properly be considered by the Executive Director. Nor can it properly be considered by this panel. The proper venue for such an appeal would be in the Court of Appeal, pursuant to an appeal under section 38 of the Act.

27. The real question before us is whether Pewter's lack of MFDA membership demonstrates that its registration as a mutual fund dealer would be unsuitable or objectionable.

28. It is worth considering the context in which the requirement for MFDA membership originated, including the underlying regulatory policy objectives and concerns. In the face of tremendous growth in the mutual fund industry during the 1980s and 1990s, the Commission, and its counterparts in other Canadian jurisdictions, determined that our regulatory objectives of protecting investors and fostering market confidence and efficiency would be best served by mandating a regime of self-regulation of mutual fund dealers, much as a self-regulatory system already applied to full-service securities dealers (the IDA). A self-regulatory regime, it was felt, could provide superior monitoring and enforcement activities through an SRO comprised of industry members who, arguably, know the industry best. Among the public interest considerations that the Commission and its counterparts determined should be addressed by an SRO for mutual fund dealers were regulatory monitoring and review of compliance, and enforcement action in the event of non-compliance. After a lengthy process of public consultation across Canada, the Commission and its counterparts fostered the formation and recognition of the MFDA for that purpose. In Alberta, section 16 of the Rules was amended to require exchange or SRO (in this case, MFDA) membership as a condition of mutual fund dealer registration.

29. The requirement for MFDA membership under section 16(c)(ii) of the Rules is thus designed to serve important securities regulatory objectives. Without very compelling circumstances, the absence of MFDA membership can properly be

considered to demonstrate unsuitability for registration as a mutual fund dealer, or that such registration would be objectionable.

30. Pewter had urged that it be exempted from the requirement to be an MFDA member in the same fashion as certain other mutual fund dealers had been exempted by the Commission. The Executive Director rejected that argument on the grounds that the circumstances were not analogous. Those other mutual fund dealers had been exempted from MFDA membership because their trading activities as mutual fund dealers were limited to non-public clients (their management, employees and families) and were only incidental to their principal business activities as a portfolio advisor or manager. We agree with the Executive Director. Pewter is engaged full-time in the business of selling mutual funds to the public. The basis on which exemption from the MFDA membership requirement was granted to the other dealers is not applicable to Pewter.

31. In our view, therefore, the Executive Director was correct when he in effect found Pewter unsuitable for registration as a mutual fund dealer and its application for renewed or amended registration objectionable. We find that he did not err in denying Pewter such renewed or amended registration.

***Should the Commission exempt Pewter, on certain conditions, from the requirement under section 16(c)(ii) of the Rules that every mutual fund dealer be a member of the MFDA?***

32. The second aspect of Pewter's appeal was its proposal that it be registered as a mutual fund dealer on specific conditions that would obviate the need for it to be an MFDA member.

33. Pewter suggested a number of conditions that could be imposed on its registration that, it argued, would exceed the MFDA requirements for its members and provide better protection to the investing public than is provided by membership in the MFDA.

34. The question we need to determine is whether the conditions suggested by Pewter would be an acceptable alternative to MFDA membership and not prejudicial to the public interest.

35. We reviewed Pewter's proposed conditions. Pewter's proposal provided in certain areas more stringent financial and operational requirements than those required by the MFDA. However, its proposal failed to address two key aspects of MFDA membership referred to earlier: compliance and enforcement by an organization with regulatory authority.

36. Pewter in its oral argument acknowledged that its proposed conditions did not include provision for compliance reviews and enforcement proceedings by a regulator.

Pewter then suggested that this deficiency might be addressed by its engaging a third party or the Commission itself to review Pewter's compliance.

37. In our view, which is bolstered by the decisions and process that led to the recognition of the MFDA and the amendment of section 16 of the Rules as discussed earlier, compliance reviews and enforcement action by a regulator are critical regulatory functions for the maintenance of market integrity and public confidence in the capital markets. Pewter has not persuaded us that a third-party contractual arrangement would be a satisfactory alternative.

38. We do not accept the suggestion that the Commission itself rather than the MFDA should directly regulate and enforce Pewter's compliance. The Commission historically had direct responsibility for the regulation of mutual fund dealers and their salespersons. That is no longer the case. As noted earlier, although the Commission may from time to time take direct action where it sees fit, the conversion to a self-regulatory registration regime reflected the determination of the Commission and its counterparts that this aspect of regulation would be better conducted by an SRO comprised of industry members who, arguably, know the industry best. A fragmented system, with some industry participants included and others not, could have been implemented if it had been thought appropriate, but that was not done.

39. The requirement that a full-time mutual fund dealer be an MFDA member is fundamental to our registration regime for mutual fund dealers. Any departure from this requirement must satisfy the significant policy and administrative considerations that this regime was designed to address. Pewter has not satisfied us that its proposed conditions provide the same safeguards to the investing public as membership in the MFDA.

40. More broadly, given the deliberations that led to the establishment and recognition of the MFDA, we do not consider it appropriate for us to construct an alternative regime to the MFDA in response to this specific application.

41. Accordingly, we are not satisfied that it would be appropriate for Pewter to be exempted from the requirement to be a member of the MFDA on the conditions suggested by it.

## **Decision**

42. For these reasons and subject to the variation described below, we confirm under section 36(3) of the Act the decision of the Executive Director dated February 25, 2002 to deny Pewter's application to renew or amend its registration as a mutual fund dealer under section 76 of the Act, but to permit Pewter's interim registration as a mutual fund dealer to continue for a limited period despite it not being a member of the MFDA.

43. Pewter's current interim registration was allowed by the Executive Director to continue in order to permit the making, hearing and determination of this appeal. That

interim registration could also, in the event that the Executive Director's decision concerning the need to become an MFDA member were upheld, permit a period of time for Pewter to make application to the MFDA and for the MFDA to consider and process that application.

44. We heard from Pewter that it had recently undergone a compliance review by Commission staff that we understand resulted in no unresolved material concerns about the operation of its business. We understand that applications for MFDA membership are decided upon, after review, at monthly MFDA meetings, but that no such meeting is scheduled for July or August. We also understand that, with the implementation of the National Registration Database and Multilateral Instrument 33-109 *Registration Information*, all registrants with annual registrations, irrespective of the anniversary date of their current registration, must renew their annual registration to coincide with the calendar year commencing on January 1, 2004.

45. In light of these very particular factors, we consider it to be appropriate and not prejudicial to the public interest to permit Pewter to continue to be registered as a mutual fund dealer for a limited period to permit it to apply for MFDA membership and for that application to be processed. Accordingly, we vary the Executive Director's decision to extend the registration of Pewter as a mutual fund dealer for an interim period, despite it not being a member of the MFDA, by specifying that this interim period will terminate not later than December 31, 2003.

46. July 7, 2003

47. **For the Commission**

“Original Signed By”

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Glenda A. Campbell, Q.C., Vice-Chair

“Original Signed By”

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Stephen R. Murison, Vice-Chair