



June 22, 2009
With Addendum of August 11, 2009

Report of Task Force on Governance Issues

PART A INTRODUCTION AND CONTENTS

This Report has been prepared by the MFDA Task Force on Governance Issues established by the Board of Directors as a summary of its work and recommendations. The Report was provided initially to the Board in draft form for consideration and comment and this version has been revised with the benefit of the Board's comments and on the basis of further deliberation by the Task Force.

At the meeting of the Board of Directors of the MFDA immediately following the Annual General and Special Meeting of Members held on December 4, 2008, the Governance Committee was directed to review the governance issues that had arisen at the AGM and to consider for recommendation to the Board appropriate responses and actions. The primary issues that arose and were identified were as follows:

- By-law 15 relating to the definition of Public Directors and the terms of office of directors.
- The selection and nomination process for Board members.
- By-law and rule making / amending process.
- Constitution of the Board following the AGM.

The content of the Report has been organized as follows:

PART A	Introduction and Contents.....	1
PART B	Executive Summary	3
PART C	Task Force.....	4
	Establishment of Task Force.....	4
	Terms of Reference.....	4
	Composition.....	4
	Conflicts of interest.....	4
	Task Force's Work	4
	Meetings.....	4
	Consultation	4
	Comments Received from Consultation.....	5

Deliberations and Report	5
Background on Issues	5
Previous History of MFDA with Subject Issues.....	5
Evolution of SROs in Canada.....	5
Comparator Organization Processes.....	6
PART D Recommendations and comments.....	6
General.....	6
Responses to Consultation	6
Time Constraints.....	6
Related Issues.....	6
Rule Making.....	7
Process	7
Special Meeting	7
Nomination Process	7
Substantive Issues	8
Board Composition	8
Selection of Directors	9
Nomination Process and Criteria	9
PART E Implementation Process and Schedule.....	11
CSA Application and Approval Process.....	11
Consideration of Comments and Final Report.....	11
Special Meeting of Members.....	11
Nomination Process for 2009 AGM	12
2009 AGM to be Held.....	12
Mandatory Review of Process	12

ADDENDUM

Following the completion of the draft of the Report and the further consultation contemplated by Part E, the Task Force prepared the final version of the Report to be dated June 22, 2009 on the basis described in the ADDENDUM of August 11, 2009.

ATTACHMENTS

1. Terms of Reference
2. Task Force members
3. Minutes of Task Force meetings
4. MFDA Bulletins
5. Comments Received – First Comment Period
6. Proposed Revised By-laws
7. Minutes of IFIC/Federation and Member Regulation Forum meetings
8. Comments Received – Second Comment Period

PART B EXECUTIVE SUMMARY

The Task Force has been asked to consider and make recommendations to the Board of Directors in respect of certain issues affecting the governance of the MFDA that arose at its Annual General and Special Meeting of Members held on December 4, 2008. The following is a summary of the Task Force's main conclusions and recommendations:

Member Participation

Many of the issues that arose at the 2008 AGM of the MFDA appear to reflect dissatisfaction among some members with the degree to which they participate in the affairs of MFDA as a self-regulatory organization ("SRO") including its governance and the development of rules and policies. The Task Force has attempted to address these concerns while at the same time preserving the elements of the MFDA's structure that permit it to function effectively as an SRO and represent the diversity of its members.

Selection of Two Industry Directors

The key recommendation of the Task Force is the introduction of a revised director nomination process by which at all times two Industry Directors would be selected by the members at large. The practical result of this process will be that small/medium size firms will be assured a determinative voice in selecting a portion of the Industry Directors because they represent a large majority of the membership.

By-law 15 and Increased Size of Board

The principal amendments proposed by By-law 15 – namely, creating four two-year terms of office for all directors and making the definition of Public Directors more flexible – are confirmed. However, the size of the Board would be increased by two (to 15, adding one Public and one Industry Director) and a one-year cooling off period for Public Directors would be mandatory.

Nomination Process and Criteria

The director nomination procedures, the criteria for director selection and the opportunity for all members to participate in it will be enhanced and clarified – and will be made transparent to members and the public.

Implementation

The recommendations of the Task Force are proposed to be implemented as quickly as possible including by way of a special meeting of members to be held on October 2, 2009 at which they will be considered. In the meantime members will have a formal comment period during the summer to express their views. Comments received from members and other interested parties will be considered by the Task Force and this Report with its recommendations, revised as considered appropriate, will be submitted to the Board of Directors for acceptance. The goal is to have the recommendations effective, if possible, for the 2009 AGM.

PART C TASK FORCE

ESTABLISHMENT OF TASK FORCE

Terms of Reference

At the meeting of the Board of Directors held on January 28, 2009, the Terms of Reference for the Task Force were adopted, a copy of which is attached to this Report.

Composition

The issues identified as a result of the 2008 AGM were considered to be within the mandate of the Governance Committee. The possibility of an independent third party review was also considered but determined not to be desirable in the circumstances. However, it was recognized that some broader participation by persons not immediately involved with the Committee or MFDA management itself would be appropriate. Accordingly, two further members were added to the Governance Committee members to compose the Task Force, being a representative of a smaller MFDA member firm (Tom Martin) and a person who satisfied the qualifications of a Public Director of the MFDA (Paul Moore). A list of the Task Force members is attached to this Report.

Conflicts of interest

An issue that was considered by the Board of Directors, the Governance Committee and the Task Force itself was the extent, if any, by which members of the Task Force were in conflict of interest in view of the fact that issues to be considered by the Task Force related to the tenure of the members as directors of the MFDA. It was determined that such a conflict was inherent to a degree for most of the directors of the MFDA in that their tenure may be affected either immediately or at some point in the future. The addition of two outside members to the Task Force was intended to mitigate any difficulties that might arise or be seen to arise as a result of the composition of the Task Force.

TASK FORCE'S WORK

Meetings

The Task Force met on the following dates: March 27, April 7, April 14, May 19, May 26, June 10 and June 16, 2009. The minutes of those meetings are attached to this Report.

Consultation

The Terms of Reference of the Task Force required it to consult with the appropriate constituencies who have an interest in the issues under review. Accordingly, the Task Force identified as the primary constituencies the members of the MFDA, member associations, the members of the Board of Directors, the MFDA management and staff and the members of the Canadian Securities Administrators having jurisdiction over the MFDA. Formal and informal communication and consultation has occurred including, most importantly, notices and bulletins to MFDA members. Attached to this Report are copies of MFDA Bulletins 356-M, 365-M and

366-M. Bulletin 366-M dated April 16, 2009, in particular, contained a specific request to comment on suggested proposals that the Task Force wished commentators to address. All such Bulletins are posted on the MFDA's website and are available to the public. In addition, representatives of members of the CSA were consulted informally and through correspondence between the MFDA and the British Columbia Securities Commission as being responsible for CSA oversight of the MFDA.

Comments Received from Consultation

The Task Force was pleased to receive a number of thoughtful and constructive comments from the consultation process. The 14 written comments received, together with a summary of them, are attached to this Report.

Deliberations and Report

The Task Force deliberated at length on the issues within its Terms of Reference and attempted to identify the relevant considerations in their resolution and develop solutions. In particular, the Task Force found the comments received from the consultation process to be most useful. As a result of its deliberations and review, the Task Force has prepared this Report and respectfully submits the recommendations set out in Parts B and C below. Particulars of the process by which the Report will be made available to members for further comment, and the Board is expected to receive and consider the Report, are set out in Part E Implementation Process and Schedule below.

BACKGROUND ON ISSUES

Previous History of MFDA with Subject Issues

The issues that arose as a result of the 2008 AGM were not new to the MFDA to the extent they related to the process for nominating and selecting directors of the MFDA. This subject had arisen at more than one AGM in the past after the reconstitution of the MFDA's governance structure as a result of the MFDA's Corporate Governance Report in 2003 and on which its current By-laws and Board selection process is based. As a result of concerns raised, the MFDA Governance Committee and Board considered the concerns raised and discussed them with the interested members as well as representatives of the CSA. The result of those reviews and discussions was that the form and structure of the MFDA's director nomination and selection process was confirmed up to the time of the 2008 AGM.

Evolution of SROs in Canada

The issues considered by the Task Force raised a number of practical governance issues as well as broader policy considerations relating to self-regulation in the Canadian financial services industry. For instance, the Task Force is aware of the developing role of SROs in Canada and the exercise of oversight authority by securities regulators in determining acceptable governance structures. The separation of regulatory and industry representation roles in SROs is also a relatively recent phenomenon and the way in which a governance structure addresses the public interest and the interests of members underlies some of the issues addressed by the Task Force.

Comparator Organization Processes

The MFDA, as a financial services SRO in Canada, has no close comparators other than the Investment Industry Regulatory Organization of Canada ("IIROC"), which is the self-regulatory organization serving securities dealers in Canada. The 2003 Corporate Governance Report of the MFDA reviewed a number of comparator organizations and the Task Force noted those results. The closest comparator remains IIROC and, with respect to the process for nominating and electing directors, the governance structures of the MFDA and IIROC are similar.

PART D RECOMMENDATIONS AND COMMENTS

GENERAL

The recommendations made by the Task Force as outlined below are made in the context of the following general considerations and circumstances:

Responses to Consultation

It can be concluded from the responses from members and others (which are made available with this Report) to the consultation process that there is no clear consensus on all of the issues that have been raised. In some matters, the way forward is relatively clear; whereas in others there is a divergence of views and approaches.

Time Constraints

Time is a critical consideration not only in the work of the Task Force but in permitting members and others sufficient opportunity to participate and comment and in implementing any changes recommended. In particular, the next Annual General Meeting of the MFDA members is scheduled for December 2009 and the time available to seek member approval for any changes and actually implement the changes is short. This is due to the difficulty of the issues as well as the pace at which regulatory change can occur for SROs such as the MFDA. In addition, the Task Force is aware that the current constitution and composition of the Board of Directors of the MFDA as a result of failure to pass By-law 15 at the AGM in 2008 requires resolution sooner rather than later.

Related Issues

The request for comments in Bulletin 366-M elicited a number of important issues of concern to MFDA members and others which are beyond the stated mandate of the Task Force. Examples of such issues are the role of approved persons in the governance of MFDA as well as whether a weighted voting system should be introduced. These issues are significant and related to varying degrees to the issues within the Task Force's mandate. However, in view of the constraints of the mandate and the time available to deal with the matters, the Task Force has not made any recommendations with respect to them. This is not to say, however, that such issues should be ignored and the Task Force recommends that they be brought to the attention of the Board of Directors of the MFDA for further consideration and action, as appropriate.

Rule Making

Of the four significant issues identified by the MFDA Board of Directors following the 2008 AGM, the basis on which rule making for MFDA members should occur was quickly identified as a larger and more difficult issue than could be dealt with effectively by the Task Force in the time available. Accordingly, the Task Force, with the approval of the MFDA Board, decided not to seek comments on that process because it would unlikely be able to achieve any change before the 2009 AGM (if change were considered to be desirable) and the review would distract from the immediate solutions required with respect to the composition of the Board of Directors. However, it is acknowledged that the basis on which policy is developed for MFDA members and rule changes are effected is closely related to the issues within the Task Force's mandate. Again, as with the related issues referred to in the preceding section, the Task Force recommends that this matter continue to be considered by the MFDA Board of Directors. In this regard, the Task Force takes some comfort in the fact that the MFDA staff and Board have improved the policy development processes and, in particular, the current Strategic Plan recently adopted by the MFDA (and to be posted on its website shortly) emphasizes this as a priority.

PROCESS

Special Meeting

Recommendation No. 1: The Task Force recommends that the MFDA hold a special meeting of its members on October 2, 2009 to consider and, if appropriate, approve By-law 15 and the related matters requiring member approval in this Report.

Comment: There is a relatively broad consensus in member comments that a special meeting of the members of MFDA should be held to consider the necessary changes to the By-laws of the MFDA and related processes. The alternative would be to have such changes brought to the scheduled 2009 AGM and seek approval for the changes but actually act on them in the Board selection at the AGM. The changes to the By-laws would be essentially those in By-law 15 proposed for approval at the 2008 AGM with the further provisions increasing the number of the Board to 15 and the incidental technical changes resulting from the other recommendations in this Report. A copy of draft proposed By-law 15 is attached to this Report.

Nomination Process

Recommendation No. 2: The Task Force recommends that the MFDA initiate its nomination director process for its 2009 AGM before any recommended changes are implemented as a result of the special meeting to be held.

Comment: This approach need not preclude any subsequent changes to the basis on which directors are to be nominated and selected but there is no time to wait until final approvals are obtained.

SUBSTANTIVE ISSUES

The issues identified in the mandate of the Task Force and the comments received from members may be roughly divided into three categories for convenience of analysis, namely, (a) Board composition, (b) director selection and (c) Board nominating process.

Board Composition

Size

Recommendation No. 3: The Task Force recommends that the number of directors of the Board be increased to 15.

Comment: The Task Force has proposed that the size of the MFDA Board be increased from 13 to 15 to more easily accommodate one further Industry Director who will likely represent a small or medium firm as well as the consequential addition of one Public Director to maintain the balance of Industry and Public Directors required.

Terms of Office

Recommendation No. 4: The Task Force recommends the adoption for all directors of four two-year terms with an eight year maximum term of office as proposed in By-law 15.

Comment. The Task Force is of the view that the reasons expressed by the MFDA recommending the changes reflected by By-law 15 remain valid. The lack of turnover in the composition of the MFDA Board to date has been more the result of circumstance than a deficient governance structure or any desire to perpetuate the current membership. A significant turnover in the MFDA Board will begin to occur in 2010. The terms of office and eight year maximum will allow MFDA to benefit from directors who have had a chance to develop familiarity and expertise with MFDA affairs. This approach is consistent with the IIROC governance structure.

Two Board Members to be Selected by Members

Recommendation No. 5: The Task Force recommends that the composition of the Board of Directors of the MFDA include at all times two Industry Directors of the MFDA selected by members in the manner proposed as part of the nomination process described in the section Nomination Process and Criteria below.

Comment: This recommendation is the key to the amendments that are proposed by the Task Force in this Report. The objective is to create a fair and workable balance in the director nomination process by (1) providing the ability for MFDA members (particularly small and medium size members) to select a portion of the Industry Directors, and (2) preserving the benefits of the current directors selection process that will ensure MFDA's mandated board diversity is achieved. The Task Force is aware of the fact that well over a majority of the MFDA membership is composed of what can be termed small and medium sized firms. Therefore, in the selection process for two Industry Directors proposed below the choices of that constituency of members will be expected to be determinative.

Selection of Directors

Recommendation No. 6: The Task Force recommends that the existing process for selecting the directors of the MFDA at its AGMs and as reflected in By-law 15 be continued in accordance with the current practice, subject to the determinative role of members in the process of selecting two nominees as Industry Directors recommended in this Report.

Comment: By-law 15 as proposed at the 2008 AGM reflects most of the recommendations of the Task Force but would require minimal, technical amendments such as those relating to the increase of the number of directors and transitional provisions as set out in the draft By-law attached to this Report. The key changes required to ensure the selection of two Industry Directors by the members would be contained in the adopted nomination procedures described below.

Nomination Process and Criteria

Based on the recommendations of the Task Force on the process and substantive issues referred to above, the Task Force has considered carefully the nominating procedures and criteria that will support the recommendations made. These procedures and criteria will primarily be contained in the Terms of Reference of the Governance Committee as well as a detailed outline of the nomination and selection process to be made available to members and the public. To the extent necessary, certain provisions may be included in the By-laws of MFDA.

Clear and Transparent

Recommendation No. 7: The Task Force recommends that the procedures for Board of Director selection and the criteria applicable be reviewed and rewritten to include as much detail and guidance to members and others, as appropriate, and that all such information be made available publicly on the MFDA website and by related communications.

Comment: The Task Force is of the view that the procedures and criteria by which Industry and Public Directors of MFDA are selected should be clear and transparent and available not only to members but to the public as well. Accordingly, such procedures and criteria would be available on the website of the MFDA as well as in its published constitution and other materials made available to members. This is not a change of current MFDA policy.

Active Solicitation

Recommendation No. 8: The Task Force recommends that the MFDA review and improve its processes for actively soliciting recommendations for directors of the Board.

Comment: The Task Force has observed that the number of potential nominees or volunteers to act as Industry Directors of the MFDA has been minimal in some years. It is necessary that the MFDA and its Governance Committee be proactive in seeking, identifying and soliciting recommendations for nominees.

Method of Selection for Two Industry Directors

Recommendation No. 9: The Task Force recommends that a direct member ballot or similar process for director nominees be adopted for the two Industry Directors who are to be selected by the MFDA members at large.

Comment: The details of the procedures by which members will have the opportunity to ensure that at all times two Industry Directors of their choice will be selected will be provided to members for review with the materials to be presented for consideration at the special meeting. The Task Force envisions a direct ballot process whereby members can vote, in effect, for recommended nominees and the results will be determinative for the Governance Committee's nomination process.

Criteria for Directors

Recommendation No. 10: The Task Force recommends that the criteria applicable to persons to be recommended as nominees for MFDA members (both Industry and Public Directors) be reviewed and articulated in more detail. Such criteria would be available for members and the public to review.

Comment: The Board of the MFDA is required by its recognition orders to reflect the diversity of its members and it is important that representatives of all members – particularly small and medium size firms which are the majority of the MFDA membership – be eligible and encouraged to serve as directors. Criteria for such representatives will include legal requirements (i.e. age, association with a member firm etc.) which must be observed and some limited objective criteria such as non-involvement in material enforcement proceedings. A material enforcement proceeding would be one in which an adverse finding against the respondent would cause a reasonable person to consider that the respondent would be unfit to act as a director of the MFDA or that the reputation of the MFDA could be diminished.

Conflicts of interest

Recommendation No. 11: The Task Force recommends that the conflict of interest policy with respect to MFDA director nominees be reviewed and explicitly address potential conflicts of interest for both Public Directors and Industry Directors. A one-year cooling-off period for Public Directors who may previously have been involved in the industry would be imposed.

Comment: The principle that all directors should be able to act free of conflicts of interest that may impair their judgment is accepted by the Task Force. This principle applies to both Industry and Public Directors while recognizing that Industry Directors have a potential conflict of interest in performing a regulatory role in the industry in which they participate. However, such conflicts are inherent in a self-regulatory structure and can be managed. A one-year cooling-off period is viewed as a minimum requirement and the Governance Committee will consider each case to determine if a longer period may be warranted in the circumstances.

PART E IMPLEMENTATION PROCESS AND SCHEDULE

As noted above in this Report, there is a need to act expeditiously in respect of the issues being reviewed by the Task Force and there is limited time available. Accordingly, the recommendations of the Task Force below acknowledge that notice periods may be accelerated and steps that would preferably occur sequentially may have to overlap with each other.

Recommendation No. 12: The Task Force recommends that the process to implement recommendations made above in this Report be as follows:

Notice to Members and Request for Comments

The Board be asked for approval to send this Report to members, representatives of the CSA and other interested parties including industry associations. The Report would also be made available by publication on the MFDA website. Comments on the Report will be requested to be provided within 30 days.

CSA Application and Approval Process

Immediately following sending this Report to members as recommended above, an application for approval for the amendments of the MFDA's By-laws and its Recognition Orders be made to the relevant members of the CSA.

Comment: The foregoing application would be made on the basis that the substantive aspects of the Task Force's recommendations have already been approved by the CSA by virtue of the approval of By-law 15 preceding the 2008 AGM. However, it is recognized this approval will have to be confirmed in the current circumstances and the Task Force's further recommendations. Submissions would be made to request an expedited approval process without further public comment other than the notice to members and request for comment recommended above (30 days) and the further 30 day comment period previously provided by MFDA Bulletin 366-M.

Consideration of Comments and Final Report

Recommendation No. 13: The Task Force recommends that it receive and consider the comments of members and others and prepare the final version of the Report. The Report will then be submitted to the Board of Directors for acceptance of its recommendations and authorization to implement them, subject to changes determined by the Board and the requirements of the CSA members.

Special Meeting of Members

Recommendation No. 14: The Task Force recommends that the special meeting of members recommended to be held on October 2, 2009 be called and held and, if necessary, the approvals by members sought for By-law 15 and related matters will be subject to conditions or changes required by the CSA.

Comment: Notice of a special meeting of members to be held on October 2, 2009 would have to be sent by the end of August. In addition, it is expected and recommended that robust efforts be

made by the MFDA and its directors to fully explain the Task Force's recommendations and to solicit support from members. The information to be provided to members will include all relevant documentation including By-law 15, the criteria for directors, the special selection process for two Industry Directors and the usual notice, proxy and meeting circular.

Nomination Process for 2009 AGM

Recommendation No. 15: The Task Force recommends that the nomination process for the election of directors at the 2009 AGM begin in the normal course and initially proceed on the assumption that the necessary changes to the MFDA's By-laws and Governance Committee Terms of Reference will be made to reflect the recommendations made.

Comment: The nomination process for directors to be elected at the MFDA's AGM each year normally starts early in the summer of each year and the recommendation above is consistent with that practice. In addition, it is recognized that a nomination process will be required whether or not By-law 15 is approved by the members and that the Governance Committee will be able to conduct its activities according to the circumstances as they may arise. If By-law 15 is approved at the AGM but the necessary regulatory approvals have not been confirmed, one possibility would be to defer the election of the directors at the AGM to a later time. If By-law 15 is not approved, there are expected to be six Public Directors and three Industry Director vacancies that would have to be filled at the 2009 AGM under the existing MFDA By-laws and nomination process.

2009 AGM to be Held

Recommendation No. 16: The Task Force recommends that the calling and holding of the 2009 AGM be determined according to the outcome of the special meeting of members to be held on October 2, 2009.

Comment: The MFDA is required to hold an AGM in 2009. The process and schedule recommended by this Report will accommodate the holding of the AGM by the end of the year and the Board and Governance Committee will be able to proceed – including in their selection of the nominations to fill Board vacancies that may arise – according to the circumstances.

Mandatory Review of Process

Recommendation No. 17: The Task Force recommends that the recommendations in this Report, their implementation and the experience of the MFDA, its Board and its members as a result of their implementation be reviewed after the third MFDA AGM at which the recommendations have been in effect.

Comment: The recommendations of the Task Force in this Report are made in the circumstances described in Parts A and C above. The Task Force is aware that some of its recommendations are in response to the immediate issues raised in connection with the 2008 AGM and that other, longer term amendments may be in order. Accordingly, a thorough review would be required after three years experience with the adopted amendments. Such a review would include consultation with members and the other interested parties identified in this

Report. In the meantime, the Governance Committee will monitor the implementation of the recommendations and their effect on the governance of the MFDA.

ADDENDUM – August 11, 2009

The process and schedule proposed by the Task Force for finalizing, approving and implementing the Recommendations in this Report were proposed in Part E of the draft dated June 22, 2009.

The approval of the Board of the MFDA to send the draft Report to members, the CSA and other interested parties was granted at the meeting of the Board held on June 22, 2009. Accordingly, and pursuant to Recommendation No. 12, the MFDA posted the draft Report on its website and by Bulletin #0384-M (attached) invited members and other stakeholders to forward comments on the Report to the MFDA by July 30, 2009. Also pursuant to Recommendation No. 12, the MFDA applied to the relevant CSA members for the approvals and orders necessary to implement the Report's Recommendations.

The MFDA received comment letters from members in response to Bulletin #0384-M. Copies of the submissions (attached) were reviewed by the Task Force and provided to the Board of Directors. The Chair of the Task Force and staff also met with the Investment Funds Institute of Canada and the Federation of Mutual Fund Dealers on July 8, 2009 and with members at an MFDA Member Regulation Forum on July 20, 2009. Copies of the minutes of those meetings are attached.

A number of the Recommendations relating to the MFDA's director selection process contemplate that the Terms of Reference of the Governance Committee be revised. The Task Force advised and commented on such revised Terms of Reference and related procedures as prepared for the Governance Committee to be recommended for adoption by the Board. Copies of the revised Terms of Reference, if and when adopted by the Board, are to be included for member review in the materials to be sent in connection with the special meeting of members proposed to be held on October 2, 2009 as advised in Bulletin #387-M dated July 7, 2009.

The Task Force held its final meeting on August 11, 2009 at which it considered the Recommendations in the draft Report in light of the comments received and events since June 22, 2009 described in this Addendum. At that meeting, the Task Force completed the final version of the Report for submission to the Board together with its advice as to the Terms of Reference of the Governance Committee and other procedures relating to the MFDA director selection process. The Board of Directors of the MFDA is to meet and consider the Report and its Recommendations for acceptance on August 18, 2009. The release of this Report in final form dated June 22, 2009 will confirm the Report's acceptance by the Board.