



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels
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MEMBER REGULATION NOTICE

AUTOMATIC CONVERSION OF DEFERRED SALES CHARGE TO 0% FRONT END LOAD UNITS WITHOUT CLIENT KNOWLEDGE OR CONSENT

MFDA staff has become aware of arrangements entered into by mutual fund managers and MFDA Members and their Approved Persons, which involve the automatic conversion of clients' units of a mutual fund with a deferred sales charge ("DSC") into units of the same mutual fund carrying a 0% front-end load without client knowledge or consent. MFDA staff has identified regulatory concerns with the manner in which some of these arrangements or programs have been structured.

10% Free Redemption Automatic Rebalancing Programs

Members and/or Approved Persons are entering into arrangements with certain mutual fund managers whereby clients' 10% free units in DSC funds each year are redeemed automatically and switched into units of the same fund carrying a 0% front-end load. Mutual fund managers often effect this conversion through a "bulk switch" of all eligible DSC units held by clients of the Member or Approved Person.

Automatic Switch of Matured DSC Units into Units Carrying a Front-End Load

A similar arrangement identified by MFDA staff involves the automatic conversion of clients' units where the DSC has fallen to zero (matured DSC units) into units of the same mutual fund carrying a 0% front-end load.

Regulatory Concerns with Arrangements

MFDA staff has identified the following regulatory concerns with the manner in which some of these arrangements or programs have been structured:

- **No Client Knowledge or Consent** - In the arrangements described above, the bulk switch of clients' DSC units to units of the same fund carrying a front-end load is often effected without the prior knowledge or consent of the client.

- **No Disclosure of Increased Trailer Fee** - Typically, the front-end load units into which the DSC units are switched will entitle the Approved Person to a higher trailer commission. Disclosure of the increased trailer fee is not provided to the client.
- **Tax Implications** – The switch of units from DSC to FEL may have tax implications if it is considered a disposition. In many cases the tax implications of the switch is not considered by either the manager or the Member.

MFDA Requirements

MFDA staff is of the view that the manner in which some of these automatic conversion programs are currently structured does not comply with MFDA Rules. In order to comply, Members and their Approved Persons must ensure that appropriate disclosure is provided and the consent of the client is obtained prior to engaging in an automatic conversion program. The disclosure/consent form should include the following:

- A signature line to evidence client consent to the switch;
- Disclosure of any increased remuneration, including trailer fees;
- Disclose of any tax implications; and
- Reference to the applicable fund prospectus.

Where client consent is obtained prior to the commencement of the program, the Member should notify clients each year prior to the annual switch. Such notice can be done by means of a negative confirmation letter.

Non-Automatic Switches

Members and Approved Persons are reminded that non-automatic switches initiated by the Member or Approved Persons are considered trades under securities legislation and all normal trade requirements will apply. Members are reminded that:

- there may be tax implications for trades in non-registered plans; and
- the client should be advised of any increased remuneration, including increased trailer fees, resulting from the switch.

Automatic Switch Programs Disclosed in Fund Prospectus

This Notice is not intended to apply to automatic conversion programs where a mutual fund has included the information in the fund prospectus.