Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 Notice of Commission Approval – IIROC Dealer Member Rule 43 Personal Financial Dealings with Clients and Amendments to IIROC Dealer Member Rule 18.14 Registered Representatives and Investment Representatives

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (IIROC)

RULE ON PERSONAL FINANCIAL DEALINGS WITH CLIENTS

AND

AMENDMENTS TO RULE ON REGISTERED REPRESENTATIVES AND INVESTMENT REPRESENTATIVES

NOTICE OF COMMISSION APPROVAL

The Ontario Securities Commission approved IIROC's Dealer Member Rule 43 Personal *Financial Dealings with Clients and amendments to Dealer Member Rule 18.14 Registered Representatives and Investment Representatives* (collectively, the **Amendments**). In addition, the British Columbia Securities Commission did not object to, and the Alberta Securities Commission, the Autorité des marchés financiers, the Saskatchewan Financial Services Commission, the Financial Services Regulation Division of the Department of Government Services of Newfoundland and Labrador, the Nova Scotia Securities Commission and the New Brunswick Securities Commission approved the Amendments.

The Amendments are intended to achieve the following objectives:

(1) to clearly articulate that any personal financial dealings with clients, subject to limited exemptions, is considered inappropriate conduct, a conflict of interest and a violation of the general business conduct standards; and

(2) to codify IIROC's prior position regarding outside business activities, by imposing specific and positive obligations on Registered Representatives and Investment Representatives to disclose any outside business activities to the Dealer Member and obtain the approval of the Dealer Member before engaging in any outside business activities in order for the Dealer Member to ensure that they are not inappropriate or give rise to a conflict of interest.

The Amendments were published for comment on May 28, 2010, at (2010) 33 OSCB 4921 for a 90 day comment period. IIROC made immaterial changes to the May 28, 2010 publication reflecting its responses to public comments and comments from the Recognizing Regulators.

IIROC is also issuing, concurrent with the Amendments, guidance relating to the disclosure and approval of outside business activities.

A copy of the IIROC Notice and guidance note is attached.

RULES NOTICE

NOTICE OF APPROVAL/IMPLEMENTATION –

PERSONAL FINANCIAL DEALING AND OUTSIDE BUSINESS ACTIVITIES

13-0162
June 13, 2013

Introduction

This Rules Notice provides notice of approval by the applicable securities regulatory authorities of amendments to the Dealer Member Rules concerning personal financial dealing and outside business activities (collectively, the "amendments"). The new personal financial dealing rules will be known as Dealer Member Rule 43 – *Personal Financial Dealings with Clients*. Copies of new Dealer Member Rule 43 and revised Dealer Member Rule 18.14, which deals with outside business activities of Registered Representatives and Investment Representatives, are included within Attachment A.

The amendments will take effect on December 13, 2013. In the case of existing arrangements referred to in Dealer Member Rule 43.2(5)(i), such as employees or Approved Persons that may be acting as a Power of Attorney, trustee, executor or otherwise have full or partial control or authority over the financial affairs of a client, such arrangements must be unwound or compliant with Dealer Member Rule 43 by June 13, 2014.

Objectives of the amendments

The amendments are intended to achieve the following objectives:

(1) to clearly articulate that any personal financial dealings with clients, subject to limited exemptions, is considered inappropriate conduct, a conflict of interest and a violation of the general business conduct standards; and

(2) to codify IIROC's prior position regarding outside business activities, by imposing specific and positive obligations on Registered Representatives and Investment Representatives to disclose any outside business activities to the Dealer Member and obtain the approval of the Dealer Member before engaging in any outside business activities in order for the Dealer Member to ensure that they are not inappropriate or give rise to a conflict of interest.

Summary of the new Rules

The new Rules encompass the following:

1. *Personal Financial Dealing with Clients*

As noted in IIROC Rules Notice 10-0155, *Personal Financial Dealing and Outside Business Activities Proposals*, IIROC staff believes that a specific rule which prohibits personal financial dealing with clients is an important step in IIROC's ongoing pursuit of its investor protection objective.

As such, Dealer Member Rule 43 - *Personal Financial Dealings with Clients*, is a principles-based rule that generally prohibits all employees and Approved Persons of a Dealer Member from directly or indirectly engaging in any personal financial dealing with clients. This prohibition is consistent with IIROC staff's view that any personal financial dealing with clients creates an unacceptable conflict of interest between the Dealer Member's employee or agent and the client and as such, it is contrary to both the standards set out in IIROC Dealer Member Rule 29.1 as well as the conflict of interest rules set out in IIROC Dealer Member Rule 42 and National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. Dealer Members are reminded that, consistent with their general supervisory obligations, adequate policies and procedures and supervision should be in place to address personal financial dealing with clients.

Dealer Member Rule 43 also provides a list of the type of activities that, subject to limited exemptions, would be considered to be personal financial dealing with clients. These activities include, but are not limited to:

- Accepting any consideration from a person, other than the Dealer Member, for any activities conducted on behalf of a client, unless through an approved outside business activity.

- Entering into a settlement agreement with a client without the Dealer Member's prior written consent or paying for client account losses out of personal funds without the Dealer Member's prior written consent.

- Borrowing from clients or lending to clients, unless the client is a Related Person under the *Income Tax Act (Canada)*.

- Acting as a Power of Attorney, trustee, executor or otherwise having full or partial control or authority over the financial affairs of a client, unless the client is a Related Person under the *Income Tax Act (Canada)* or the authority is exercised in accordance with the IIROC rules within a discretionary or managed account.

At the time of issuance of this notice, for the purpose of the *Income Tax Act (Canada)*, "Related Persons" include:

> "(a) individuals connected by blood relationship, marriage or common-law partnership or adoption;
>
> (b) a corporation and (i) a person who controls the corporation, if it is controlled by one person, (ii) a person who is a member of a related group that controls the corporation, or (iii) any person related to a person described in subparagraph 251(2)(b)(i) or 251(2)(b)(ii); and
>
> (c) any two corporations if: (i) they are controlled by the same person or group of persons, (ii) each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation, (iii) one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation, (iv) one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation, (v) any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or (vi) each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation."

Also under the *Income Tax Act (Canada)*, persons are connected by:

> "(a) blood relationship if one is the child or other descendant of the other or one is the brother or sister of the other;
>
> (b) marriage if one is married to the other or to a person who is so connected by blood relationship to the other;
>
> (b.1) common-law partnership if one is in a common-law partnership with the other or with a person who is connected by blood relationship to the other; and
>
> (c) adoption if one has been adopted, either legally or in fact, as the child of the other or as the child of a person who is so connected by blood relationship (otherwise than as a brother or sister) to the other."

For an official copy of the definition, Dealer Members should refer to section 251 of the *Income Tax Act (Canada)*.

The text of new Dealer Member Rule 43 is included within Attachment A.

2. *Outside business activities*

The amendments to Dealer Member Rule 18.14 expand the scope of the conditions set out in current Dealer Member Rule 18.14 from other gainful occupations to outside business activities and clarifying that Registered Representatives and Investment Representatives must inform the Dealer Member of any outside business activities and obtain the Dealer Member's approval to engage in any such outside business activities prior to engaging in the activity. Consistent with IIROC's prior position and Dealer Member practices, the amendments further clarify that the Dealer Member must notify IIROC of the outside business activity within the time period and manner required by the applicable National Instrument.[1]

The text of revised Dealer Member Rule 18.14 is included within Attachment A.

Related guidance

IIROC is also issuing, concurrent with this Rules Notice, guidance relating to the disclosure and approval of outside business activities. The guidance sets out:

[1] At the time of issuance of this Notice, Dealer Members should refer to National Instrument 33-109 *Registration Information.*

(a) A summary of the requirements relating to the disclosure and approval of all outside business activities;

(b) Some considerations relating to the approval of outside business activities;

(c) Dealer Members' supervisory responsibilities relating to outside business activities; and

(d) Filing requirements – National Registration Database ("NRD") relating to outside business activity.

Please refer to Rules Notice 13-0163 for the guidance on *Disclosure and approval of outside business activities*.

Publication for comment and summary of written comments

The new rules

The amendments to the IIROC Dealer Member rules were published for comment with IIROC Rules Notice 10-0155 on May 28, 2010. IIROC staff has considered all of the comments received and thank all of the commenters. A summary of the comments received, as well as IIROC staff's response to the comments is enclosed as Attachment C.

The scope of the amendments remains the same as the proposed amendments that were published for comment in May, 2010. IIROC has made revisions to the rules to address the comments received and to clarify its expectations with regards to personal financial dealing with clients and outside business activities. None of the revisions are substantive in nature. Therefore, the revisions have not been republished for a further comment period. A black-lined copy of the final rules, detailing the revisions made since the publication for comment of proposed amendments in May, 2010, is enclosed as Attachment B.

The Guidance Note

The Guidance Note was published for comment with IIROC Rules Notice 11-0150 on May 11, 2011. IIROC staff has considered all of the comments received and thank all the commenters. A summary of the comments received and IIROC staff's response to the comments is enclosed as Attachment D. The scope of the Guidance Note remains the same. IIROC staff has, however, made some revisions to address the comments received and to clarify IIROC's position relating to the disclosure and approval of outside business activities.

Summary of changes

In response to CSA and public comments received, IIROC has made some minor revisions to the rules relating to personal financial dealing with clients and outside business activities. Noteworthy changes made since the publication in May, 2010, are as follows:

Personal financial dealing with clients

Wording was added to clarify that the list of types of personal financial dealings set out in Rule 43 is not exhaustive.

Wording was added to clarify that the prohibition against receiving consideration for activities conducted on behalf of a client does not include compensation received in exchange for services provided through an approved outside business activity.

Wording was added to clarify that receiving or providing a guarantee, in relation to borrowing or lending money, is captured by the prohibition against borrowing from or lending to clients any money, securities or other assets.

Outside business activities

Wording was added to clarify that the disclosure of the outside business activities by a Registered Representative or Investment Representative to their Dealer Member, and the Dealer Member's approval of such activities, must be done prior to engaging in such outside business activity.

Implementation plan

The new rule relating to personal financial dealing with clients will be known as Dealer Member Rule 43 – *Personal Financial Dealings with Clients*. Copies of new Dealer Member Rule 43 and revised Dealer Member Rule 18.14 are included within Attachment A. The amendments will take effect on December 13, 2013. In the case of existing arrangements referred to in Dealer Member Rule 43.2(5)(i), such as employees or Approved Persons that may be acting as a Power of Attorney, trustee, executor or otherwise have full or partial control or authority over the financial affairs of a client, such arrangements must be unwound or compliant with Dealer Member Rule 43 by June 13, 2014.

IIROC is issuing guidance relating to the disclosure and approval of outside business activities concurrently with this Rules Notice as Rules Notice 13-0163.

Attachments

Attachment A - Dealer Member Rule 43 - *Personal Financial Dealings with Clients and Dealer* Member Rule 18.14 relating to outside business activities (clean)

Attachment B - Dealer Member Rules 43 and 18.14, black-lined to the previously published version

Attachment C - Summary of public comments received and IIROC staff response to comments on the previously published amendments

Attachment D- Summary of public comments received and IIROC staff response to the comments on the previously published draft Guidance Note

Attachment A

to Rules Notice 13-0162

Rule 43

PERSONAL FINANCIAL DEALINGS WITH CLIENTS

43.1 An employee or Approved Person of a Dealer Member must not, directly or indirectly, engage in any personal financial dealings with clients.

43.2 Personal financial dealings include, but are not limited to, the following types of dealings:

(1) **Accepting any consideration**

(i) Except as described in sub-clauses 43.2(1)(i)(a) and 43.2(1)(i)(b) below, accepting any consideration, including remuneration, gratuity or benefit, from any person other than the Dealer Member for any activities conducted on behalf of a client.

(a) Consideration that is non-monetary, of minimal value, and infrequent such that it will not cause a reasonable person to question whether it created a conflict of interest or otherwise improperly influenced the Dealer Member, its employees or agents would not be considered to be consideration for the purposes of clause 43.2(1)(i).

(b) Compensation received from a client in exchange for services provided through an approved outside business activity would not be considered to be consideration for the purpose of clause 43.2(1)(i).

(2) **Settlement agreements without the Dealer Member's approval**

(i) Entering into a settlement agreement without the Dealer Member's prior written consent; or

(ii) Paying for client account losses out of personal funds without the Dealer Member's prior written consent.

(3) **Borrowing from clients**

(i) Borrowing money or receiving a guarantee in relation to borrowing money, securities or any other assets from a client, unless:

(a) The client is a financial institution whose business includes lending money to the public and the borrowing is in the normal course of the institution's business; or

(b) The client is a Related Person as defined by the Income Tax Act (Canada) and the transaction is addressed in accordance with the Dealer Member's policies and procedures; and

(c) In the case of Registered Representatives and Investment Representatives, the arrangement set out in sub-clause 43.2(3)(i)(b) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(4) **Lending to clients**

(i) Lending money, or providing a guarantee in relation to a loan of money, securities or any other assets to a client, unless:

(a) The client is a Related Person as defined by the Income Tax Act (Canada) and the transaction complies with the Dealer Member's policies and procedures; and

(b) In the case of Registered Representatives and Investment Representatives, the arrangement set out in sub-clause 43.2(4)(i)(a) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(5) **Control or authority**

(i) Acting as a Power of Attorney, trustee, executor, or otherwise having full or partial control or authority over the financial affairs of a client, unless:

(a) The client is a Related Person as defined by the Income Tax Act (Canada) and the existence of such control is addressed in accordance with the Dealer Member's policies and procedures; and

(b) In the case of Registered Representatives and Investment Representatives, the arrangement in sub-clause 43.2(5)(i)(a) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(ii) In the case of discretionary and managed accounts, clause 43.2(5)(i) does not apply to the extent that the control or authority exercised is consistent with the Corporation's applicable requirements for such accounts.

Revised IIROC Dealer Member Rule 18.14 (clean copy)

18.14.

(1) A Registered Representative or Investment Representative may have, and continue in, any business activity outside of the Dealer Member, including another gainful occupation if:

(a) The securities commission in the jurisdiction in which the Registered Representative or Investment Representative acts or proposes to act as a Registered Representative or Investment Representative, or the securities legislation or policies administered by such securities commission, does not prohibit him or her from devoting less than his or her full time to the securities business of the Dealer Member employing him or her;

(b) The Dealer Member establishes and maintains procedures acceptable to the Corporation to ensure continuous service to clients and to address potential conflicts of interest;

(c) The Registered Representative or Investment Representative informs the Dealer Member of the outside business activity and obtains the Dealer Member's approval to engage in such outside business activity prior to engaging in such outside business activity;

(d) The Dealer Member notifies the Corporation of the outside business activity within the time period and manner required by the applicable National Instrument or Regulation; and

(e) The outside business activity is not:

(i) One which would bring the securities industry into disrepute; or

(ii) With another dealer that is a member of a recognized self regulatory organization unless:

(1) Such dealer is a related company of the Dealer Member employing the Registered Representative or Investment Representative and the Dealer Member and related company provide cross-guarantees pursuant to Rule 6.6, and

(2) Such outside business activity is not contrary to the provisions of the applicable securities legislation or any policy made pursuant thereto.

Attachment B

to Rules Notice 13-0162

~~Proposed~~ Rule ~~"X"~~ 43

PERSONAL FINANCIAL DEALINGS WITH CLIENTS

~~X~~43.1 ~~A Registered Representative, Investment Representative, Director, Executive, Supervisor, or employee~~ An employee or Approved Person of a Dealer Member must not, directly or indirectly, engage in ~~or permit any associate to engage in,~~ any personal financial dealings with clients.

~~X~~43.2 Personal financial dealings include, but are not limited to, the following types of dealings:

(1) **~~Benefits or other~~Accepting any consideration**

(i) Except as described in sub-clauses 43.2(1)(i)(a) and 43.2(1)(i)(b) below, ~~A~~accepting any consideration, including remuneration, gratuity or benefit, from any person other than the Dealer Member for any activities conducted on behalf of a client.

(~~ii~~a) Consideration that is non-monetary, of minimal value~~,~~ and infrequent such that it will not cause a reasonable person to question whether it created a conflict of interest or otherwise improperly influenced the Dealer Member, its employees or agents would not be considered to be ~~material~~ consideration for the purposes of clause 43.2(1)(i).

(b) Compensation received from a client in exchange for services provided through an approved outside business activity would not be considered to be consideration for the purpose of clause 43.2(1)(i).

(2) **~~Private s~~Settlement agreements without the Dealer Member's approval**

(i) Entering into a ~~private~~ settlement agreement ~~with a client~~without the Dealer Member's prior written consent; or

(ii) Paying for client account losses out of personal funds without the Dealer Member's prior written consent.

(3) **Borrowing from clients**

(i) Borrowing money or receiving a guarantee in relation to borrowing money, securities or any other assets from a client, unless:

(a) The client is a financial institution whose business includes lending money to the public and the borrowing is in the normal course of the institution's business; or

(b) The client is a Related Person as defined by the Income Tax Act (Canada) and the transaction is addressed in accordance with the Dealer Member's policies and procedures; and

(c) In the case of Registered Representatives and Investment Representatives, the arrangement set out in ~~paragraph~~sub-clause 43.2(3)(i)(b) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(4) **Lending to clients**

(i) Lending money, or providing a guarantee in relation to a loan of money, securities or any other assets to ~~a client or incurring any other liabilities for~~ a client, unless:

(a) T~~t~~he client is a Related Person as defined by the Income Tax Act (Canada) and the transaction ~~is addressed in accordance~~complies with the Dealer Member's policies and procedures; and

(b) In the case of Registered Representatives and Investment Representatives, the arrangement set out in sub-clause 43.2(4)(i)(a) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(5) ~~Power of Attorney~~ Control or authority

(i) Acting as a ~~power~~Power of ~~attorney~~Attorney, trustee, executor, or otherwise having full or partial control or authority over the financial affairs of a client, unless:

~~(a) The account is a discretionary or managed account and the authority exercised is consistent with the Corporation's applicable requirements; or~~

(~~b~~a) The client is a Related Person as defined by the Income Tax Act (Canada) and the existence of such control is addressed in accordance with the Dealer Member's policies and procedures; and

(~~c~~b) In the case of Registered Representatives and Investment Representatives, the arrangement in ~~Paragraph~~sub-clause 43.2(5)(i)(~~b~~a) is disclosed to and approved in writing by the Dealer Member, prior to the transaction.

(ii) In the case of discretionary and managed accounts, clause 43.2(5)(i) does not apply to the extent that the control or authority exercised is consistent with the Corporation's applicable requirements for such accounts.

Revised IIROC Dealer Member Rule 18.14 (clean copy)

18.14.

(1) A Registered Representative or Investment Representative may have, and continue in, any business activity outside of the Dealer Member, including another gainful occupation if:

(a) The securities commission in the jurisdiction in which the Registered Representative or Investment Representative acts or proposes to act as a Registered Representative or Investment Representative, or the securities legislation or policies administered by such securities commission, ~~specifically permit~~does not prohibit him or her ~~to devote~~from devoting less than his or her full time to the securities business of the Dealer Member employing him or her;

(b) The Dealer Member establishes and maintains procedures acceptable to the Corporation to ensure continuous service to clients and to address potential ~~problems of conflict~~conflicts of interest;

(c) The Registered Representative or Investment Representative informs the Dealer Member of the outside business activity and obtains the Dealer Member's approval to engage in such outside business activity prior to engaging in such outside business activity;

(d) The Dealer Member notifies the Corporation of the outside business activity within the time period and manner required by the applicable National Instrument or Regulation; and

(e) The outside business activity is not:

(i) One which would bring the securities industry into disrepute; or

(ii) With another dealer that is a member of a recognized self regulatory organization unless:

(1) Such dealer is a *related company* of the Dealer Member employing the Registered Representative or Investment Representative and the Dealer Member and related company provide cross-guarantees pursuant to Rule 6.6, and

(2) Such outside business activity is not contrary to the provisions of the applicable securities legislation or any policy made pursuant thereto.

Attachment C

to Rules Notice 13-0162

Re: IIROC response to comments on the proposed personal financial dealings rule and proposed amendments to the IIROC Dealer Member Rule 18.14

This summary responds to the eight comment letters received on the proposed personal financial dealing rule and the proposed amendments to IIROC Dealer Member Rule 18.14 (collectively referred to as the "Proposal") that were published for comment on May 28, 2010. We have considered the comments received and we thank all the commenters for their submissions. The comments specific to the Proposal have been summarized to correspond with the major components of the proposed amendments, followed by IIROC staff response to each specific comment. We have summarized and grouped the comments according to the Dealer Member Rule and issues raised. Our response follows each particular issue.

For ease of reference, in this response to comments, a Registered Representative, Investment Representative, director, executive, supervisor, or employee of a Dealer Member are collectively referred to as a "Dealer Member Representative".

PROPOSED PERSONAL FINANCIAL DEALINGS RULE

1. **Personal Financial Dealing Situations**

One commenter requested that if there are no other dealings meant to be included under the phrase personal financial dealings, then the word "include" should be changed to the word "means" under Section X.2.

IIROC staff response

The drafting of the proposal has been revised to clarify that other dealings may be considered to be personal financial dealings and the list of personal financial dealings set out in X.2 (renumbered as 43.2) is non-exhaustive.

2. **Reference to 'associate'**

One commenter requested further guidance regarding as to who "associate" in Section X.1 refers.

IIROC staff response

The reference to "associate" has been removed as proposed section X.1 (renumbered as 43.1) already prohibits direct or indirect personal financial dealings with clients.

3. ***Private Settlement Agreements***

Mutual agreement between client and advisor setting out the terms of fee for service is a long-standing and well-accepted practice.

IIROC staff response

The private settlement agreements referred to in the Proposal relate to settlement agreements entered into directly between a Dealer Member Representative and a client in response to an actual, or potential, complaint or law suit, and not in reference to service agreements. We have amended the proposed Rule to clarify our intention. The prohibition set out in proposed section X.2(2) (renumbered as 43.2(2)) is consistent with the current requirements set out in Dealer Member Rule 3100 regarding settlement agreements without the prior consent of the Dealer Member.

With respect to service agreements, IIROC staff would like to remind Dealer Member Representatives that pursuant to IIROC Dealer Member Rule 18.15 no Registered Representative or Investment Representative may accept or permit any associate to accept, directly or indirectly, any remuneration, gratuity, benefit or any other consideration from any person other than the Dealer Member or its affiliates or related companies, for the securities related activities he or she conducts on behalf of the Dealer Member or its affiliates or its related companies. This is an existing requirement. Accordingly, any fees paid by the client pursuant to the terms of a service agreement must go through the Dealer Member. To ensure compliance with the provisions of Dealer Member Rule 18.15, the Dealer Member should be able to identify and have access to the service agreement in order to conduct supervision of fee-based accounts. It is common practice for the Dealer Members to approve and control any service agreement, or mandate standard service agreements, between a client and a Dealer Member Representative in order to ensure compliance with the above noted requirements.

4. Benefits or other consideration

(i) One commenter suggested that Section X.2(1)(i) be amended to add "unless the activity has been approved by the Member under Rule 18.14" at the end.

IIROC staff response

We have added a new provision which will clarify that compensation received from a client in exchange for services provided through an approved outside business activity would not be considered to be consideration for the purpose of paragraph X.2(1)(i) (renumbered as 43.2(1)(i)) and therefore would not be considered to be personal financial dealing with clients within the meaning of the rule.

(ii) One commenter requested further guidance on how to determine whether something is considered a material consideration.

IIROC staff response

The Proposed Rule has been amended and the reference to "material" consideration has been omitted. Any consideration received by a Dealer Member Representative from any one, other than the Dealer Member, for any activities conducted on behalf of a client is prohibited. However, consideration that is non-monetary, of minimal value and infrequent such that a reasonable person would not question whether it creates a conflict of interest or improperly influences the Dealer Member or Dealer Member Representative is set out as an exemption from the general prohibition.

(iii) One commenter suggested that it would be more conducive to ethical conduct if the value of work, such as debt management, were recognized openly, the fee disclosed and the client, the only possible source for such fee, would pay for it.

IIROC staff response

To the extent that such activities are outside the scope of activities conducted by a Dealer Member or the Dealer Member Representative, then these activities must be disclosed to and approved by the Dealer Member.

5. Borrowing from and lending to Clients

One commenter suggested that Sections X.2(3) and (4) of the Proposed Rule introduces unnecessary regulatory and administrative burdens where regulatory concerns are not present, particularly with respect to personal financial arrangements, such as a loan from a parent to a child, which may routinely occur. It is recommended that a further exemption be included so as to ensure that those situations not intended to be caught by the rule are excluded.

IIROC staff response

The provisions in question have been included based on current regulatory concerns over the potential for abuse and inappropriate use of the funds.

The Proposal does provide for an exemption for borrowing or lending arrangements involving family members. The disclosure and approval of such familial arrangements is only required when such a loan is between a client who is a related person of a Registered Representative or Investment Representative, as there is a greater risk of inappropriate conduct.

Section X. 2(3) and (4) have been renumbered as 43.2(3) and (4) respectively.

6. Discretionary and Managed Accounts

One commenter suggested that no Registered Representative or Investment Representative should act under a power of attorney over the financial affairs of a client unless it is in furtherance of a discretionary or managed account and the power of attorney specifically limits the power to the affairs directly related to that discretionary or managed account.

IIROC staff response

The exemption in paragraph X.2(5) (renumbered as 43.2(5)) is not intended to allow the use of power of attorneys for those who operate a discretionary or managed account. For further clarification, the proposed Rule has been amended to more clearly state that the general prohibition set out in section X.2(5) does not apply to discretionary or managed accounts provided that the control or authority exercised over such accounts is consistent with IIROC's requirements for such accounts.

7. Power of Attorney, Trustee, Executor and other Authorizations

(i) Four commenters suggested that IIROC investment professionals should have the same abilities as other professionals to accept power of attorney or executor and trustee appointments from all clients under the supervision of their Dealer Member firm and that rather than the proposed prohibition, supervision and control systems should be put in place to protect the clients.

IIROC staff response

IIROC believes that any personal financial dealing with a client creates an unacceptable and material conflict of interest between the Dealer Member Representative and the client that cannot be adequately addressed through disclosure, enhanced supervision and/or additional reporting requirements, and should therefore be avoided.

When a Dealer Member Representative also acts as a client's power of attorney, trustee or executor, a potential conflict of interest is created. To clarify, a conflict of interest clearly arises from the fact that a Dealer Member Representative has a profit motive, whereas a trustee or an executor has a fiduciary obligation to the granter. The profit motive is in conflict with the fiduciary duty imposed upon a trustee or executor. Furthermore, in a power of attorney relationship there is a conflict of interest between the duties of the attorney to the grantor and the duties and interests of the Dealer Member Representative in his/her role with the Dealer Member given that the Dealer Member Representative benefits directly from increasing the size of their book. For instance, if a Dealer Member Representative has authority over a client's assets elsewhere, the Dealer Member Representative would have an incentive to move those assets into the account at the Dealer Member without the client having any control, or knowledge, over such use of the assets. This creates a clear and undeniable conflict of interest in addition to significant potential for abuse, particularly when dealing with vulnerable clients.

Having any type of control or authority over a client's assets, such as in a power of attorney relationship, creates the types of situations where there is a real potential for abuse, such as misappropriation of funds. Abuse has often occurred where a power of attorney has been granted to a Dealer Member Representative by friends or clients. It is therefore IIROC staff's position that such arrangements need to be prohibited, subject to the exemptions provided in the Proposal when dealing with related persons. It should be noted that this prohibition is consistent with current industry practices.

From a broader policy perspective, it is also important to note that allowing Dealer Member Representatives to act as power of attorney, executor or trustee would be inconsistent with other IIROC rules. Current IIROC Dealer Member rules, and other related rules (proposed plain language rule 3271) currently awaiting securities commission approval, do not allow Dealer Member Representatives to have trading authority over a client's account or operate a discretionary account on an on-going basis as such arrangements would be effectively operating a managed account without complying with the requisite requirements (proficiency, supervision, etc.). Clearly, in comparison to an on-going discretionary account or trading authority granted over a client's account, acting as a power of attorney, executor or trustee is broader in scope. As such, it would be unreasonable and inconsistent to allow a broader scope authority, such as power of attorney, over the client's overall financial affairs.

In response to the commenter's comparison to professionals such as lawyers, it is important to note that many of the other professionals cited by the commenter already owe a fiduciary obligation to their clients; Dealer Member Representatives are not necessarily subject to fiduciary standards.

(ii) What qualifications are needed for an IIROC Dealer Representative to be a trustee or executor and who is responsible for ensuring that such credentials are held by the Dealer Representative?

IIROC staff response

As set out in attached proposed Rules, a Dealer Member Representative cannot act as a power of attorney, trustee, executor or otherwise have authority or control over the financial affairs of a client, except when dealing with a related person as defined in the *Income Tax Act* or if authority of a client's accounts is consistent with the Corporation's requirements relating to discretionary accounts and managed accounts.

(iii) One commenter does not believe that this is an area that IIROC can justify regulating and questioned whether there is a demonstrated need for an outright ban by IIROC and suggested that IIROC conduct a study to determine if there is in fact a problem.

IIROC staff response

IIROC is empowered to and responsible for regulating the conduct of its Dealer Members and Dealer Member Representatives, including their business and/or personal financial dealings with clients. In light of that obligation and authority, it is incumbent on IIROC to identify and, where necessary, prohibit specific activities which create, or potentially create, material conflicts of interest between Dealer Members, including

their Dealer Member Representatives, and their clients. IIROC staff is of the view that the conflict of interest and potential conflict of interest arising from the types of personal financial dealing activities set out in the rules is so significant that it is not necessary to undertake a separate study in this area.

As previously mentioned, the types of activities prohibited by the Proposal are activities which give rise to the potential for abuse, particularly when dealing with vulnerable clients.

8. General Comments

(i) One commenter suggested that the role of supervision should be emphasized in the proposals.

IIROC staff response

Dealer Members are expected to adequately supervise all activities of their Dealer Member Representatives. The requirement to supervise is set out in the current IIROC Dealer Member Rules. IIROC will further emphasize the importance of supervision in the Implementation Notice relating to this proposal.

(ii) One commenter questions what constraints should be applied to ensure that the Dealer Member Representatives are acting fairly, honestly and in good faith?

IIROC staff response

Dealer Members must design and implement policies and procedures that promote regulatory compliance and high business conduct standards. These policies and procedures must include supervision and reporting requirements. As well, they need to be clearly communicated to Dealer Member Representatives to ensure that their conduct is fair, honest and in good faith.

(iii) One commenter questions the extent to which Dealer Members will be held accountable for the decisions taken by the Dealer Member Representative?

IIROC staff response

Dealer Members have a general obligation to supervise the activities of their Dealer Member Representatives. The extent of the Dealer Member's liability will depend on the facts of the case and on whether the nature and extent of the supervision was adequate and reasonable in the circumstances.

(iv) One commenter suggested the following: (a) penalty guidelines be provided, (b) an increase in fines that are to the account of the Dealer Member, leaving the Dealer Member to effect collection, and (c) punitive damages be added to the investor protection tool kit.

IIROC staff response

All Dealer Members are monitored for compliance with IIROC Rules. Any Rule breaches are corrected and, in appropriate cases, pursued through an enforcement action. Any changes to the enforcement powers and penalty guidelines are outside the scope of this project.

(v) One commenter requested further clarification as to who IIROC is referring to when describing a "client" throughout the Guidance Notice. Is it a client of the firm or a client of the individual registrant? One commenter suggests that IIROC introduce a distinction between clients of the firm, generally and clients who are directly serviced by the individual registrant. The commenter provides an example in which an advisor makes a personal loan to a friend who has an unrelated discount brokerage account with the advisor's firm and argues that this activity should not be captured under this requirement; in contrast, a higher standard is warranted where the advisor makes a personal loan to a friend who is also a client directly serviced and advised by that advisor.

IIROC staff response

Both the Dealer Member and an individual Dealer Member Representative have obligations to the client and to that extent the client is a client of both the Dealer Member and the individual registrant. With respect to the application of the attached Proposed Rules and Guidance Note, the client is the client of the firm. As such, an Approved Person may not accept any consideration from a client of the Dealer Member, whether or not that Approved Person is the designated Registered Representative on the client's account. Although the real or perceived conflicts are more tangible where the advisor makes a personal loan to a friend who is directly serviced and advised by that same advisor, or by another advisor in the same branch or region, it is difficult to set out all types of situations where a lower standard may be acceptable. Accordingly, a general prohibition is needed in order to create consistency and certainty.

(vi) One commenter suggested that the definition of a Related Person as defined under the Income Tax Act be included in the Proposed Rule or as an attachment to the Proposed Rule for ease of reference for members.

> ***IIROC staff response***
>
> We have set out the relevant section number of the *Income Tax Act*, section 251(1), as well as the current definition, in our implementation notice.

DEALER MEMBER RULE 18.14

1. Outside Business Activities

(i) One commenter requested additional information as to what IIROC is attempting to capture under Proposed Rule 18.14(d) and what ultimately would need to be reported to IIROC.

> ***IIROC staff response***
>
> Proposed Rule 18.14(c) will require a Registered Representative (RR) and Investment Representative (IR) to:
>
> - inform his or her Dealer Member of all business activity that the RR or IR are involved in outside of the Dealer Member; and
> - obtain the approval of the Dealer Member.
>
> This would include any outside business activity for which the RR/IR expects to, or actually receives, direct or indirect benefit, payment or compensation. The Registered Representative or Investment Representative may only engage in such outside business activities upon approval by the Dealer Member.
>
> IIROC staff is also of the view that when a Registered Representative or Investment Representative provides certain additional services to a client which are outside the scope of his/her registerable activities (for example: looking after a client's GIC business outside of the Dealer Member), these activities are subject to the disclosure and approval requirements set out in proposed Rule 18.14(c). Although there may not be any immediate compensation for those activities, they may be undertaken in an effort to generate more business (i.e. expected benefit) from the client.

(ii) One commenter explains that outside business activity is a source of many investor complaints. Off-book sales is on top of the list. The proposed amendments will require that all outside business activities be disclosed to and approved by the Dealer Member. We agree but believe that IIROC should make three points clear:

1. Any such approval requires the Dealer Member to perform post-approval monitoring and supervision.
2. Any undue losses incurred by clients as a result of the approval shall be for the account of the firm, NOT the dealer representative.
3. The firm should advise the client that outside business activity that has been approved and delineate the scope of that activity and the extent to which the firm will accept liability in the event that things go awry.

> ***IIROC staff response***:
>
> The following is the position of IIROC staff with regards to each of the comments made above:
>
> 1. Dealer Members must supervise the activities of the Dealer Member Representative to ensure that the outside business activities do not create any real or potential conflicts of interest.
> 2. The facts and circumstances of the case would be a factor in determining whether the Dealer Member Representative and/or the Dealer Member is held accountable for any client losses, including whether the Dealer Member failed to properly supervise the activities of the Dealer Member Representative.
> 3. The requirement to address, control and/or avoid conflicts of interest is currently addressed in section 13.4 of NI 31-103 and will further be addressed under the proposed Client Relationship Model amendments.

(iii) Two commenters are concerned about the impact of the proposal on financial planning activities engaged in by some Dealer Member Representatives.

IIROC staff response

The intent of this proposal is to deal with the issue of outside business activities generally; any issues relating financial planning activities engaged in by some Dealer Member Representatives is not within the scope of this project.

(iv) One commenter requested clarification as to why Section 18.14(d) makes it the Dealer Member's responsibility to report the outside business activities within seven days, whereas under NI 33-109 it is the individual registrant's obligation to report within seven days.

IIROC staff response

For consistency with current practices, Dealer Member Rule 3100, and Member Regulation Notice 0162 - Policy 8 - *Information Regarding Reporting* ("MR0162") , it is the Dealer Member Representative's responsibility to report the activity to the Dealer Member, and the Dealer Member's responsibility to report the activity to the regulators.

(vi) One commenter requested further clarification as to whether the Proposed Amendments extend beyond the listed parties, Registered Representatives and Investment Representatives, to all positions within a Dealer Member, similar to those individuals required to complete Item 10 of National Instrument 33-109F4 ("NI 33-109 F4").

IIROC staff response

Proposed Rule 18.14 will only be applicable to Registered Representatives and Investment Representatives. However, the outside business activities of other Approved Persons will be subject to similar approval requirements in order to comply with section 13.4 of NI 31-103. As noted in the comment, such outside business activities would have to be disclosed as per NI 33-109F4.

(vii) One commenter suggested that Section 18.14(e)(ii) contain an exemption for registrants who have roles with parent companies, affiliates or subsidiaries that are not IIROC Members.

IIROC staff response

The Proposed Amendments are not a prohibition against all outside business activities, but rather simply require that the activity be disclosed to and approved by the Dealer Member in order for the Dealer Member to ensure that it is not inappropriate, detrimental to the public interest or such that it would bring the industry into disrepute. Disclosure of such activities is equally important as such a position may create a conflict of interest. Any position with a parent company, affiliate or subsidiary of a Dealer Member is presumably disclosed to and approved by the Dealer Member and we do not see the need for setting out a specific exemption. The position of IIROC staff will be clarified in the related Guidance Note; any position with a parent, affiliate or subsidiary of a Dealer Member is not prohibited, although in most cases, it can be presumed that the position has been approved by the Dealer Member, nonetheless the position must be disclosed in order to ensure that it is disclosed to the relevant regulator.

(viii) One commenter suggested that Notice MR0434 be repealed so that Dealer Members are only required to consider the Proposed Amendments to avoid confusion.

IIROC staff response

IIROC staff has issued a new Guidance Note on disclosure and approval of outside business activities which replaces previously issued MR0434.

Attachment D

to Rules Notice 13-0162

Re: IIROC response to public comments on draft Guidance Note "Disclosure and approval of outside business activities"

This summary responds to the three comment letters received on the proposed Guidance Note on disclosure and approval of outside business activities, published for public comment on May 11, 2011. We have considered the comments received and we thank all the commenters for their submissions.

The comments have been summarized and are followed by IIROC staff responses to the comments.

General comments relating to the scope of the notice and the definition of outside business activities

- One commenter suggests amending the definition of outside business activities by eliminating references to any other activity which may give rise to potential conflict of interest or client confusion; the commenter's concern is that the proposed definition is capturing a broad range of non-business involvement.
- The same commenter suggests amending the disclosure requirements by eliminating the requirement to disclose the business activities that place an approved person in a position of influence over a potential client.
- The commenter recommends that involvement in non-business outside activity should not be subject to the disclosure, approval, record-keeping and NRD requirements unless the activity is being formally marketed to clients and the number of hours devoted to the activity exceeds 10% of the average of hours worked per week.

IIROC staff response

The definition of outside business activities and IIROC expectations relating to disclosure of outside business activities is consistent with the current requirements set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103). In drafting the proposed definition, IIROC staff considered the following:

- Currently, section 13. 4 of NI 31-103 requires the identification of not only existing conflicts of interest but also potential conflicts of interest that may arise between an individual acting on a firm's behalf and a client. Accordingly, any activity that could result in a potential conflict of interest will also have to be identified. Outside business activities are one type of activity from which an existing or potential conflict of interest may arise.
- As per Form 4 of National Instrument 33-109 *Registration Information* (NI 33-109F4), Dealer Members and Approved Persons are required to provide information regarding all business-related officer or director positions, or any other equivalent position held, whether or not compensation is received. Consistent with the current CSA expectations, IIROC currently expects disclosure of any activity that places an individual in a position of power or influence as part of the outside business activities disclosures.

The IIROC proposed rules, consisting of both those set out in IIROC Rules Notice 10-0155 and those discussed in the relevant proposed Guidance Note (IIROC Rules Notice 11-0150) were drafted for consistency with the above noted requirements. We have however, amended the definition of "outside business activities" in the Guidance Note as follows:

> *"Any business activity conducted outside of the Dealer Member by an Approved Person, for which direct or indirect payment, compensation or other consideration or benefit is received or expected".*

Furthermore, we have clarified that consistent with the requirements and expectations set out by the provincial securities regulators, the principles set out in the Guidance Note equally apply to any other activities by which a potential conflict of interest or client confusion may arise.

- One commenter suggests that compliance with Dealer Member Rules 29.1 and 18.14 are sufficient.

Dealer Members should note that compliance with Dealer Member Rule 29.1 and 18.14 is required and should form part of the Dealer Member's policies and procedures. However, compliance with these requirements is not an alternative method of complying with the disclosure and approval requirements.

- One commenter states that "our experience with such business activities is negative. Retail investors, particularly seniors, believe they are dealing with the firm and are shocked, when things go wrong, that they are their own". The commenter believes that there is no benefit to clients for outside business activities and any control that the dealer will have over the conflicts of interest will add costs which will ultimately flow down to the client. The commenter states that managing outside

business activities will result in dealer expenses, IIROC monitoring cost, and investor risk. The commenter is concerned that the dealer will not be accountable for any "abuses that the outside business might inflict on the client" and notes that "off book" transactions are nearly always denied.

IIROC staff response

The disclosure and approval requirements set out in the proposed rules, the existing requirements set out in NI 31-103 and those best practices set out in the Guidance Note are intended to address the issues raised by the commenter.

The alternative, not allowing any outside business activities, is not appropriate for various reasons including the fact that an outright ban may impinge on an individual's right to earn a living, given that in some cases an Approved Person may need to have outside employment or business activities to supplement their income. In fact, there are few, if any, industries or professions which ban their members from any and all outside business activities. IIROC staff believes that it is more reasonable to set out conditions and limitations under which an individual may engage in outside business activities. This approach is consistent with the expectations set out by the provincial securities regulators.

- One commenter notes that given the importance of this notice to retail investors IIROC should not depend on written submissions since historically, the number of submissions from industry participants overwhelm the few submissions from retail investors.

IIROC staff response

IIROC staff agrees that consultation with investors and industry participants are equally important and that is the basis for which we issued the Guidance Note for a 60 day public comment period; the publication was to allow all interested parties to comment on any relevant proposal. With regards to this specific proposal IIROC received one letter from an industry participant and two letters from investor representatives.

Comments relating to disclosure and approval of outside business activities:

- One commenter suggests that Dealer Members be required to disclose the distinction between their business and any approved outside business activity to clients and the public, in accordance with Section 13.4 of NI 31-103 and its Companion Policy 31-103CP. The commenter states that Dealer Members should be liable for all acts and omissions relating to the outside business activities of their representatives unless it is clear that the activity is not part of the Dealer Member's business.

IIROC staff response

IIROC staff agrees that outside business activities should be clearly disclosed to clients and such is the purpose of the proposed rules and Guidance Note relating to outside business activities. We have clarified the importance of explaining the distinction between the Dealer Member's business and the outside business activity. The issue of liability is dependent on the facts of any particular case.

- One commenter suggests that proposed IIROC Dealer Member Rule 18.14(e) be amended to include a condition similar to FINRA's Supplementary Material on FINRA rule 3270 which includes the following condition: Upon receipt of a notice of a registrant's outside business activity, the member is expected to consider whether the proposed activity will be viewed by customers or the public as part of the member's business based upon factors such as the nature of the activity and the manner in which it will be offered. The commenter further suggests that Dealer Members should not permit any activity which might cause consumer confusion.
- Another commenter suggests using an approach similar to that used by FINRA, which does not require disclosure of activities with organizations that are charitable or religious in nature.

IIROC staff response

Similar to the FINRA approach, the IIROC Guidance Note clarifies that the risk of client confusion is a factor that should be considered by a Dealer Member when deciding whether to approve an outside business activity request. The Guidance Note also specifically states that "under no circumstances should an outside business activity, which might cause consumer confusion or reflect poorly on the Dealer Member or the industry, be permitted". Furthermore, as per CSA Staff Notice 31-326 *Outside business activities*, the risk of client confusion relating to an outside business activity is a factor when assessing a party's application for registration and continuing fitness for registration.

IIROC staff does not believe that a further rule amendment is necessary, as the issue of client confusion is captured by paragraphs 18.14(e)(i) and (ii)(2).

Any outside business activity that places an Approved Person in a position of influence or conflict of interest over a client or potential client must be disclosed, whether or not it is a paid position. Examples include where an individual has a leadership role in, or sits on the board (or similar body) of, an organization, such as a

social, charitable or religious organization.

- One commenter is concerned about the requirement to pre disclose outside business activities particularly with regards to the expectation to disclose activities that would place an Approved Person in a position of influence over a potential client. One example used by the commenter is that in some cases, an Approved Person may not know or remember that he or she has been named an executor of a will. The commenter further explains that a friend or family who may have appointed the approved person as the executor may be considered as a potential client.

IIROC staff response

The issues relating to pre-disclosure and assessment of whether an activity places an approved person in a position of influence over a potential client have been addressed above.

With regards to the example used by the commenter, the first issue is whether executorships are acceptable. Assuming that the appointment is not otherwise prohibited, then the Approved Person would remain subject to the applicable disclosure and approval requirements contained in the proposed rules. Having said that, IIROC staff acknowledges that such disclosure may not be possible in some rare circumstances, for instance, where the Approved Person was not, and could not have been, aware of their appointment.

- One commenter suggested amending the reference to potential clients in the following part of the Guidance Note: "any outside business activity that places an approved person in a position of influence over a client or potential client must be disclosed…" The commenter is concerned that an Approved Person can come into regular contact with what could be described as "potential clients" in any setting outside of work. The commenter suggests changing ***potential client*** to ***future client***.

IIROC staff response

The use of potential client, rather than future client, is consistent with the language used by the CSA in NI 31-103. In order to avoid confusion, this term will be retained.

- One commenter suggests that sitting on the board of a charitable, social or other not-for-profit organization is not an activity that is likely, in the ordinary course, to give rise to potential conflicts of interest, given that board decision-making is by definition consensual or majority based rather than directive by a single member. The commenter suggests that requiring such disclosure is an inappropriate invasion of privacy, especially to the extent that the organization relates to any of the 12 groups whose rights are protected under human rights legislation.

IIROC staff response

As previously explained on page 1 of this response letter, the expectation to disclose participation on the board of directors of any organization is mandated by the provincial securities regulators. The rules do not prohibit working with any charitable organizations; rather, the requirement is simply to disclose that fact in order to ensure there are no potential conflicts of interest.

- One commenter suggests that Dealer Members should monitor their representatives for unapproved outside business activities and if unapproved activities are detected, they should report any such activities to IIROC.

IIROC staff response

As previously mentioned, Dealer Members have an obligation to identify existing and potential material conflicts of interest, including an Approved Person's outside business activities. Dealer Members are expected to take reasonable steps to identify existing and potential material conflicts of interest.

- One commenter is concerned that the notice does not contain a provision for periodic examinations to validate that the approved conditions are still applicable and points out that the notice suggests annual canvassing of staff.

IIROC staff response

Currently, Dealer Members and Approved Persons are required to report any changes to the information contained in an Approved Person's application for registration; information relating to an Approved Person's outside business activities must be disclosed on the application for registration. The annual canvassing works as a periodic examination and it is to ensure that Approved Persons are complying with the above noted requirements.

- One commenter questions how the use of separate email, fax, business cards, etc. would be enforced and what sanctions would be applicable.

IIROC staff response

Dealer Members should ensure the use of separate email, fax and business cards for anyone who engages in outside business activities. IIROC would review such procedures during the course of its audit reviewing. Determining what the appropriate sanction for non-compliance would be would depend on the circumstances of the particular case.

- One commenter suggests that "compelling" should be deleted in the following phrase "Dealer Members are reminded that they must be able to provide compelling evidence of the due diligence performed as part of their outside business activity approval process" as it is unclear and unnecessary given that the Corporation reserves the right to satisfy itself as to the sufficiency of that evidence.

IIROC staff response

IIROC staff agree and have deleted the word compelling.

Comments relating to filing on NRD

- One commenter does not agree that each employment or outside business activity should be set out as a separate item on item 10 of form 33-109F4; the commenter suggests where an individual plays a similar role in a number of affiliate/related/subsidiary companies, they should be set out as one activity in item 10. The commenter would also like the same consideration as that given to insurance activities under item 13, to be given to securities activities with a foreign affiliate.

IIROC staff response

The need for detailed information is in order to ensure that both the Dealer Member and the regulators are aware of all the detailed activities carried out by the individuals including activities carried out at a Dealer Member's affiliate/subsidiary/related companies. This is important in order to identify and address regulatory issues, such as conflicts of interest.

In response the issue of multiple entries, this is mandated through NI 33-109F4 as two different questions/issues are being addressed. Item 10 relates to the individual's current employment, item 13 relates to the individuals registration with another securities or non-securities related organization. IIROC staff would like to note that individuals who have to make such multiple entries under Item 10 and/or Item 13 can copy and paste the required information, so long as it accurately addresses the item.

- The commenter suggests changing the reporting timelines to 10-days, rather than 7 days, for consistency with recent changes to NI33-109.

IIROC staff response

The Guidance Note has been updated to clarify that the time frame for reporting has changed from 7 days to 10 days.

- One commenter suggests that the title of the officer approving the outside business activity be entered on NRD.

IIROC staff response

The title of the reviewing person can be entered on NRD. Although, not a specific requirement, IIROC staff strongly encourages this practice as such information may be requested in specific cases and would be beneficial if the Dealer Member has this information readily available.

Other comments:

- One commenter suggests amending the definition of the securities related activities in Dealer Member Rule 1 and amending IIROC Dealer Member Rules 18.14 and 18.15 to require that all securities related activities be conducted through a Dealer Member.
- One commenter suggests that if all securities related activities were required to occur though the Dealer Member, this would significantly lessen the potential liability of Dealer Members.

IIROC staff response

The definition of securities related activities and its application are outside the scope of this proposal and are currently under review as part of a separate project. The commenter's suggestion is an issue that we will be looking at as part of the separate project.

- One commenter expresses concern that firms derive profits based on their reputation and name recognition and that such recognition induces retail investors to deal with their reps outside of the business, therefore, firms should be required to

bear the cost of these outside business activities and that such responsibility will provide Dealer Members with strong incentives to police unapproved outside business activities.

IIROC staff response

The Guidance Note clearly states that under no circumstances should an outside business activity cause consumer confusion and that the business activities outside of the Dealer Member must be clearly seen to be conducted outside the Dealer Member. Accordingly, any use of the Dealer Member's name to induce investors to deal with an individual's outside business activities should be prohibited. The extent of a Dealer Member's liability and responsibility to bear the cost of any outside business activity would depends on the facts and circumstances of each case.

- One commenter recommends that IIROC and CSA members undertake to determine whether IIROC Dealer Members should be required to obtain insurance to compensate investors for harm caused by their representatives' outside business activities.

Given the current disclosure requirements and practices set out above, it is the position of IIROC staff that requiring insurance, in addition to the current FIB insurance requirements, is not necessary.

- One commenter suggests that a duty be imposed on all registrants to report breaches or suspected breaches of securities regulation.

IIROC staff response

Current Dealer Member Rule 3100 requires a registrant to report to the Dealer Member any time her/she believes that they may have violated, among other things, securities legislation. Any additional requirements, such as a requirement to report when another registrant has violated securities legislation, are outside the scope of this project.

- One commenter is concerned about the potential harm of outside business activities to seniors.
- One commenter requests IIROC to provide examples of how to focus on senior related issues.

IIROC staff response

In developing rules and guidance notes relating to outside business activities, IIROC staff considered the impact on all types of clients including more vulnerable clients such as seniors. In dealing with vulnerable clients such as seniors, Dealer Members and Registered Representatives should take extra care in disclosing and explaining the distinction between the Dealer Members' business and the outside business activity that the Registered Representative may be involved with. For example, if a Registered Representative proposes to sell an insurance product to a client outside of the Dealer Member, then extra care should be taken to explain that such products are not related to the Dealer Member's business and are sold through a separate entity.

- One commenter suggests that Registered Representatives should employ a mutually agreed upon Investment Policy Statement based on the client's NAAF and financial plan and that this will help investors detect if unsuitable investments from an outside business interest are being promoted.

IIROC staff response

The use of Investment Policy Statements is outside the scope of this project.

RULES NOTICE

GUIDANCE NOTE

DISCLOSURE AND APPROVAL OF OUTSIDE BUSINESS ACTIVITIES

13-0163
June 13, 2013
Replaces MR 0434

Background

In November 2006, the IDA issued Member Regulation Notice MR0434, *Other Business Activities* ("MR0434"), in order to provide Dealer Members and Approved Persons with guidance on the issue of business activities that, although engaged in by Approved Persons, are not performed on behalf of the Dealer Member. MR0434, among other things, explained that Dealer Members should be aware of other business activities engaged in by their Approved Persons and must have in place policies and procedures requiring Approved Persons to:

- disclose all other business activities to the Dealer Member; and
- obtain the Dealer Member's approval for such other business activities.

This Guidance Note replaces MR0434 and reflects the recent amendments to IIROC Dealer Member Rule 18.14 ("the amendments") as well as the requirements set out in National Instrument 31-103, *Registration Requirements, Exemptions and ongoing Registrant obligations* ("NI 31-103"), and National Instrument 33-*109, Registration Information* ("NI33-109").

For the purposes of this Guidance Note, "outside business activities" includes any activities conducted outside of the Dealer Member by an Approved Person, for which direct or indirect payment, compensation, consideration or other benefit is received or expected.[2]

Consistent with the requirements and expectations set out by the provincial securities regulators, the principles set out in this Guidance Note equally apply to any other activities by which a potential conflict of interest or client confusion may arise.

In this Guidance Note we have set out:

(a) A summary of the requirements relating to the disclosure and approval of all outside business activities;
(b) Some considerations relating to the approval of outside business activities;
(c) Dealer Members' supervisory responsibilities relating to outside business activities; and
(d) Filing requirements – National Registration Database ("NRD") relating to outside business activity.

Summary of the requirements relating to disclosure and approval of all outside business activities

Below we have set out a summary of the various requirements relating to outside business activities; Dealer Members should note that there are differences in the individual scope of each requirement.

- General conflicts of interest identification and disclosure requirements set out in IIROC Dealer Member Rule 42 apply to all Approved Persons.
- General conflicts of interest identification and disclosure requirements set out in NI 31-103 and the associated companion policy apply to each individual acting on behalf of a Dealer Member.
- Within the context of conflict of interest related requirements, the companion policy of NI 31-103 specifically references the need for the disclosure and approval of outside business activities of registrants.
- In addition to the above noted conflict of interest related provisions in NI 31-103 and its companion policy, recent amendments in IIROC Dealer Member Rule 18.14 specifically require Registered Representatives and Investment Representatives to disclose, and obtain the approval of the Dealer Member before engaging in, any outside business activities.
- In addition to the above noted requirements, pursuant to NI 33-109, and as required through Dealer Member Rules 40 and 3100, all Approved Persons must disclose their business activities outside of their sponsoring firm, including any business related officer or director positions and any other equivalent positions held, whether or not compensation is received.

[2] The recent amendments to IIROC Dealer Member Rules, which prohibit any personal financial dealing with clients, stipulate that receiving any compensation directly from anyone other than the Dealer Member for activities conducted on behalf of a client is prohibited. It should be noted however, that an exception is provided in the case of any compensation received from a client that is in exchange for services provided through an approved outside business activity.

- The Canadian Securities Administrators ("CSA") issued CSA Staff Notice 31-326, *Outside Business Activities* (the "CSA Notice"), to remind registrants of their obligation to ensure outside business activities do not impair or impeded the performance of their regulatory obligations, including compliance with the conflicts of interest provisions under NI 31-103. The CSA Notice sets out a number of matters relating to an individual's outside business activities that the CSA will consider when assessing an initial application for registration, a change to registration and in considering continuing fitness for registration. The CSA Notice also sets out information relating a registered firm's responsibilities for monitoring and supervising the individuals whose registration it sponsors in relation to outside business activities. As set out above, the conflict of interest provisions in NI 31-103 and IIROC Dealer Member Rule 42 require Dealer Members, and where applicable Approved Persons, to take reasonable steps to identify existing material conflicts of interest and material conflicts of interest that the Dealer Member would reasonably expect to arise between the Dealer Member, including each individual acting on behalf of the Dealer Member, and a client. Given that conflicts may arise when Approved Persons are engaged in outside business activities, and in keeping with guidance provided in the Companion Policy of NI 31-103, Dealer Members should ensure that they consider whether potential conflicts of interest may arise from an Approved Person's proposed outside business activity before approving any such activity. Furthermore, if a Dealer Member concludes that it cannot properly control a potential conflict of interest it should not permit the outside business activity.

Dealer Members' pre-approval processes should be robust and impartial enough to reasonably:

- identify the risk of client confusion and/or conflicts of interest in advance; and
- ensure that approval is only granted in cases where effective controls and qualified supervisory personnel are first in place.

Under no circumstances should an outside business activity, which might cause consumer confusion or reflect poorly on the Dealer Member or the industry, be permitted. Accordingly, the reputation of others involved with the outside business activity should be considered. Dealer Members are also reminded that they must be able to provide evidence of the due diligence performed as part of their outside business activity approval process. IIROC reserves the right to satisfy itself as to the sufficiency of that evidence.

Dealer Members are also reminded that there is also an implicit obligation to ensure that the outside business activities of all Approved Persons are compatible with the ethical standards set out in Dealer Member Rule 29.1.

Some approval considerations relating to outside business activities

Dealer Members have at times expressed an interest in receiving clearly-delineated and prescriptive direction from IIROC on outside business activities. The evolving and complex nature of the financial services industry however, necessitates that Dealer Members exercise appropriate due diligence and judgment. The following are therefore offered as considerations, but do not represent an exhaustive list of factors that a Dealer Member should consider when assessing an outside business activity:

- Outside business activities should not materially impair a Dealer Member's ability to discharge its "duty of care" to its clients. Therefore:

  - The amount of time that a Registered Representative or Investment Representative devotes to an outside business activity is an important consideration. Outside activities that are likely to hinder a client's ability to access their dealer account assets and, where it is part of the service offered, to access suitable advice should not be permitted until the prospect of such disruptions has been effectively eliminated; and
  - Outside activities (e.g. positions with public issuers) that may prevent a Registered Representative from providing fully-informed and unbiased counsel to his/her clients should not be permitted unless the conflict is disclosed and adequately controlled. Consistent with section 13.4 of NI 31-103 CP, Dealer Members and Approved Persons are reminded that some conflicts of interest are so fundamentally contrary to another person's or company's interests, that controls and/or disclosure cannot effectively address them and they should therefore, be avoided. Furthermore, as noted in Dealer Member Rule 42.2(3) any existing or potential material conflict of interest between the Approved Person and the client that cannot be addressed in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients, must be avoided.

- Outside business activities should not involve the use of client information.

  - Customers provide confidential information to Dealer Members solely for the purposes of their dealings with Dealer Members. They may also grant permission for the Dealer Member to provide that information to affiliates of the Dealer Member that provide other services that may be of interest to the customer. That permission does not, however, extend to an individual Approved Person's outside business activities. Therefore training and controls should be in place to prevent Approved Persons from making use of such information in their pursuit of outside business activities.

- Business activities "outside" of the Dealer Member must be clearly seen to be outside the Dealer Member. The distinction between the Dealer Member's business and the outside business activity should be clear to clients. Therefore:

  - The use of a Dealer Member's premises, records, logos, trade name(s), stationery, support staff or contact facilities (phone/fax numbers, mail/e-mail/instant or text-messaging addresses, etc.) while conducting outside business activities should not be permitted.
  - As noted in section 13.4 of NI 31-103CP Dealer Members should ensure that their clients are adequately informed about any conflicts of interests that may affect the services the firm provides to them. The timing of the disclosure depends on when and what a reasonable investor would expect to be informed of. Outside business activities of Approved Persons are one type of activity which may give rise to a conflict of interest for which disclosure may be needed.

- The approval and control processes for outside business activities should be robust and impartial. Therefore:

  - Dealer Members' policies and procedures, as well as their training programs (both initial and ongoing), should emphasize the requirement to disclose all outside business activities and obtain pre-approval of the outside business activities and the process by which they may seek that pre-approval. Furthermore, it would be advisable for Dealer Members to include their approval/disapproval criteria in their outside business activity policy and consider annual "outside business activity" canvasses of their staff;
  - Dealer Members' records should include complete supporting evidence regarding its handling of all outside business activity approval requests, including any special conditions, policies, procedures and controls that have been imposed and how compliance will be monitored; and
  - Approved Persons should never adjudicate their own outside business activity request.

Outside business activities should comply with both the letter and spirit of Dealer Member Rules 18.14(1)(e), 29.1 and 42 and therefore no outside business activity which might cause consumer confusion or reflect poorly on the Dealer Member or the industry should be permitted.

As part of their approval process, Dealer Members should also consider the criteria set out in CSA Notice which explains what the CSA will take into account in relation to an individual's outside business activities when assessing an individual's application for registration, change in registration or continued fitness for registration. Among other things, the CSA will consider whether: a) the outside business activity places the individual in a position of power or influence (i.e. acting as a religious leader such as a preacher or sitting on board of any organization including charities) over clients or potential clients, in particular clients or potential clients that may be vulnerable; and b) the outside business activity provides the individual with access to privileged, confidential or insider information relevant to their registerable activities.

Supervision of outside business activities

In order to comply with the requirements set out in IIROC Dealer Member Rules 18.14(1)(e), 29.1 and 42, as well as section 13.4 of NI 31-103, Dealer Members must have policies and procedures in place that:

a) Require all of their Approved Persons to disclose their outside business activities to the Dealer Member, prior to engaging in such activities;
b) Ensure that the Dealer Member has the ability to identify conflicts of interest; and
c) Determine the risks that a conflict may give rise to and respond appropriately to the conflict of interest.

Once identified, conflicts can be addressed either through avoidance or by disclosure and supervision. Conflicts of interest must be addressed in a fair, equitable and transparent manner, and considering the best interests of the client(s).

Dealer Members should refer to the CSA Staff Notice which sets out the CSA's expectations relating to a Dealer Member's responsibility to monitor and supervise outside business activities. Among other things, the Notice states that this includes ensuring the Dealer Member's Chief Compliance Officer is able to properly supervise and monitor the outside business activities; maintain proper records of such supervision; and assess whether an individual's lifestyle is consistent with the Dealer Member's knowledge of the individual's business activities as well as staying alert to other indicators of possible fraudulent activity.

Filing Requirements – National Registration Database ("NRD")

This Notice also sets out the process for reporting outside business activities, via NRD, to IIROC. Dealer Members are reminded that all Approved Persons are required to disclose their outside business activities on NRD.

Item 10 of Form33-109F4 is intended to capture all current employment information, as well as outside business activities. Individuals must treat each employment relationship or outside business activity as a separate item and therefore, make

separate entries addressing all elements below. Please also note that changes to employment relationships and outside business activities must be reported within ten (10) days of the change, pursuant to section 4.1 of NI 33-109.

This reporting requirement includes the need to update item 10, to include references to activities with any affiliate/related/subsidiary company of the Dealer Member. Although generally any position with a parent, affiliate or subsidiary of a Dealer Member would have been approved by the Dealer Member, nonetheless the position must be disclosed to the relevant regulators similar to the disclosure of any other employment relationship or outside business activity.

The reporting requirement also includes situations where the Approved Person conducts business through a "trade name" or conducts other business activities outside of the Dealer Member. Reporting of a trade name is required under item 1(3) of Form 33-109F4 if the trade name is used for purposes of Dealer Member activities. If a trade name will be used for outside business activities (e.g. insurance) the trade name is required to be filed under both item 1(3) and item 10 of NI 33-109F4.

In situations where insurance activities are being conducted through a registered insurance provider or through the Dealer Member's related/affiliate/subsidiary entity, this information only needs to be reported under item 13(3)(a) of Form 33-109F4, but must include the name of the insurance firm. In situations where the individual is conducting insurance activities through another entity, with or without other financial planning services, individuals must report this business activity under both items 10 and 13(3)(a) of Form 33-109F4 and they must address all items pursuant to guidelines provided below.

IIROC's acknowledgement of these notices, via NRD, does not represent IIROC's approval of the individual's outside business activity or that the Corporation agrees that all potential conflicts of interest have been addressed. As a result, IIROC may request further information following it's acknowledgement of the notice, where deemed necessary.

Item 10 of Form 33-109F4 requires that all business and employment activities must be disclosed, including business and employment activities outside of the individual's sponsoring firm, and including all business related officer or director positions and any other equivalent positions held, whether compensation is received or not. Any outside business activity that places an Approved Person in a position of influence over a client or potential client must be disclosed, whether or not it is a paid position. Examples include where an individual has a leadership role in, or sits on the board (or similar body) of, an organization, such as a social, charitable or religious organization.

Requirements under item 10 of the Form 33-109F4 are identified below for further clarity:

1. Start Date
2. Firm information

   - Self explanatory as presented in Form 33-109F4.

3. Description of duties

   - Disclose details here on type of business, position with firm and duties associated with the position. If the individual fails to provide full details on the type of business and the duties associated with the outside business activity, it will be considered a deficiency.

4. Number of hours per week

   - Individuals should disclose approximate number of hours devoted solely to the outside business activity on a weekly basis.

5. Conflict of interest:

   - Disclose any potential for confusion by clients and any potential for conflicts of interest arising from the activities as a registrant and the outside business activities described above
     A response to this item is required in all cases when you are involved in outside business activities. The disclosure must contain the following:

     (i) Confirmation as to whether there is any potential for confusion by clients and any potential for conflicts of interest arising from the outside business activities. In the event that the disclosure indicates no conflicts of interest are foreseen, an explanation must be provided as to why this is believed to be the case.
     (ii) The sponsoring firm must confirm that it has reviewed the outside business activity to ensure compliance with the firm's policies and procedures and the issues set out in this Notice. Confirmation must include the name and title of the officer or Supervisor who performed the review. The Approved

Person must also confirm that they are aware of the firm's policies and procedures relating to outside business activities.

IIROC may request additional information to clarify the outside business activities.

This Notice replaces previously issued MR-0434.