

SRO Notices and Disciplinary Proceedings

13.1.1 MFDA – Conflicts of Interest (Rule 2.1.4)

MFDA – CONFLICTS OF INTEREST (RULE 2.1.4)

I. OVERVIEW

A. Current Rule

Rule 2.1.4(a) currently provides that each Member and Approved Person and other employee and agent of a Member shall be aware of the possibility of conflicts of interest arising in connection with business conducted by them for a client and that in the event that such a conflict or potential conflict of interest arises, the Member must ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client.

Rule 2.1.4(b) currently provides that any conflict that arises or can reasonably be expected to arise, shall be immediately disclosed in writing by the Member to the client prior to the Member, or any person acting on its behalf in connection with its business, conducting business for the client.

B. Issues

Rule 2.1.4(a) and (c) refers to conflicts of interest arising in connection with business conducted by Members and Approved Persons for clients. The requirements of Rule 2.1.4 are intended to apply to any conflicts of interest that arise between the interests of the Member or the Approved Person and the interests of the client regardless of whether they relate specifically to Member business. This would include, for example, conflicts of interest that arise where Approved Persons are engaged in outside business activity or personal dealings with clients.

Rule 2.1.4 does not expressly require Approved Persons to report any conflicts or potential conflicts of interest that they identify to the Member. Implicit in both Rule 2.1.4(a) and (b) is the notion that where an Approved Person becomes aware of a conflict or potential conflict of interest, the Approved Person must immediately bring the conflict to the attention of the Member so as to permit the Member to ensure that the conflict is addressed through the exercise of responsible business judgment influenced only by the best interests of the client and to fulfill the obligation to provide written notice of the conflict of interest to the client.

Rule 2.1.4 (a), which requires that conflicts or potential conflicts be addressed through the exercise of responsible business judgment, does not expressly reference Approved Persons. Approved Persons are required to comply with the requirements of Rule 2.1.4 by virtue of Rule 1.1.2, which provides that each Approved Person shall comply

with the by-laws and rules "...as they relate to the Member and Approved Person."

MFDA Rule 2.1.4(a) currently references other employees or agents of the Member. The definition of "Approved Person" in By-law No.1 includes an employee or agent of the Member who participates in dealer business of the Member and who is subject to the jurisdiction of the Corporation. The reference to employees or agents of the Member in Rule 2.1.4 (a) is therefore redundant.

C. Objective

The objective of the proposed amendments is to clarify the obligations of Members and Approved Persons with respect to conflicts of interest.

D. Effect of Proposed Amendments

The proposed amendment will help to ensure that Members and Approved Persons are fully aware of their responsibilities with respect to conflicts of interest. The amendments will clarify that the requirements of Rule 2.1.4 apply equally to situations where Approved Persons are engaged in outside business activity or personal dealings with clients where the activity or transaction that gives rise to the conflict or potential conflict is not considered Member business. The proposed amendments will also assist Members in meeting their obligations under the Rule with respect to conflicts of interest by expressly requiring Approved Persons to report conflicts or potential conflicts to the Member.

II. DETAILED ANALYSIS

A. Proposed Amendment

Rule 2.1.4(a) will be amended to clarify that the requirements of the Rule apply to all conflicts that arise between the interests of the Member or Approved Person and the interests of the client. The proposed amendment to Rule 2.1.4(a) will remove the wording "in connection with business conducted by them for a client" and require Members and Approved Persons to be aware of the possibility of conflicts arising between the interests of the Member and Approved Person and the interests of the client.

The proposed amendment to MFDA Rule 2.1.4(a) is intended to clarify that, where an Approved Person becomes aware of a conflict or potential conflict of interest, the Approved Person must immediately bring the conflict of interest to the attention of the Member to enable the Member to ensure that the conflict is handled in accordance with the requirements of the Rule. Accordingly, the amendment will add the sentence "Where

an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member.” after the first sentence of Rule 2.1.4(a). The words “and other employee and agent of a Member” will also be deleted from Rule 2.1.4(a).

Rule 2.1.4 will also be amended to add the phrase “and the Approved Person” before the reference to the obligation to ensure that the conflict is addressed by the exercise of responsible business judgment influenced only by the best interests of the client.

In addition, the phrase “by the Member, or by the Approved Person as the Member directs” will be added after the reference to the obligation to disclose conflicts of interest to clients in Rule 2.1.4(b). This wording will clarify that either the Member or the Approved Person acting in accordance with the Member’s direction, is required to provide immediate written notice of a conflict or potential conflict to the client. Rule 2.1.4(b) will also be amended to remove the reference “...in connection with its business, conducting business for the client” and will add the words “...proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest.” This amendment, which is consistent with the amendment to section (a) of Rule 2.1.4 as discussed above, is intended to clarify that the requirement to provide disclosure to the client applies to all situations where there is a conflict or proposed conflict of interest.

The reference to conflicts of interest that “can reasonably be expected to arise” in Rule 2.1.4(b) will be replaced with a reference to potential conflict of interest. In addition, the wording “or any person acting on its behalf” will be replaced with “or Approved Person”. These amendments will ensure consistency with the wording in other sections of the Rule.

The last sentence of the current Rule 2.1.4(a) will become Rule 2.1.4(b), and, consequently, Rule 2.1.4(b) will be renumbered Rule 2.1.4(c) and Rule 2.1.4(c) will be renumbered Rule 2.1.4(d).

B. Issues and Alternatives Considered

No other issues or alternatives were considered.

C. Best Interests of the Capital Markets

The Board has determined that the proposed Rule amendment is in the best interests of the capital markets.

D. Public Interest Objective

The proposed amendment is in the public interest in that it will ensure that Members and Approved Persons understand their responsibilities with respect to conflicts and potential conflicts of interest that arise with clients.

III. COMMENTARY

A. Filing in Other Jurisdictions

The proposed Rule amendments will be filed for approval with the Alberta, British Columbia, Nova Scotia, and Ontario Securities Commissions and the Saskatchewan Financial Services Commission.

B. Effectiveness

The proposed amendments are simple and effective.

C. Process

The proposed amendments were developed by MFDA staff in response to comments received from Members and based on input from MFDA staff. The proposed amendments were approved by the MFDA Board of Directors.

D. Effective Date

The amended Rule will be effective on a date to be subsequently determined by the MFDA.

IV. SOURCES

MFDA Rule 2.1.4

V. OSC REQUIREMENT TO PUBLISH FOR COMMENT

The MFDA is required to publish for comment the proposed amendments so that the issue referred to above may be considered by Ontario Securities Commission staff.

The MFDA has determined that the entry into force of the proposed amendments would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1000, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

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**MUTUAL FUND DEALERS
ASSOCIATION OF CANADA**

MFDA RULE 2.1.4 (CONFLICTS OF INTEREST)

On September 14, 2005, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendment to Rule 2.1.4:

2.1.4 Conflicts of Interest

- (a) Each Member and Approved Person ~~and other employee and agent of a Member~~ shall be aware of the possibility of conflicts of interest arising ~~in connection with business conducted by them for a client.~~ between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member.
- ~~(b)~~ In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with Rules 2.1.4~~(b)(c)~~ and ~~(c)(d)~~.
- ~~(b)(c)~~ Any conflict or potential conflict of interest that arises ~~or can reasonably be expected to arise~~ as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing to the client by the Member, or by the Approved Person as the Member directs, prior to the Member or Approved Person or any person acting on its behalf proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest, in connection with its business, conducting business for the client.
- ~~(c)(d)~~ Each Member shall develop and maintain written policies and procedures to ensure compliance with Rules 2.1.4(a), ~~and (b)-~~ and (c).