

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 IIROC Rules Notice – Request for Comments - Proposed Rule on Personal Financial Dealings with Clients and Amendments to IIROC Dealer Member Rule 18.14

IIROC RULES NOTICE – REQUEST FOR COMMENTS – PROPOSED RULE ON PERSONAL FINANCIAL DEALINGS WITH CLIENTS AND AMENDMENTS TO IIROC DEALER MEMBER RULE 18.14

The nature and purpose of the proposed Rule

On April 30, 2010, the Board of Directors (“the Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved the publication for comment of the proposed Personal Financial Dealing Rule and proposed amendments to Dealer Member Rule 18.14 (the “Proposals”).

The Proposals set out in Attachment A will expressly prohibit personal financial dealings with clients. The Proposals will clarify that, subject to specific exemptions, personal financial dealing with clients includes the following types of arrangements:

- Receiving any direct or indirect benefit or consideration from clients, other than through the Dealer Member;
- Entering into any private settlement agreements with clients;
- Lending money to clients;
- Borrowing any money from clients; and
- Having any control or authority over the financial affairs of clients.

The primary objective of the proposed Personal Financial Dealing Rule is to clearly articulate that any personal financial dealing with clients, subject to limited exemptions, is considered inappropriate conduct, a conflict of interest and a violation of the general business conduct standards.

The secondary objective is to codify the current IIROC expectations relating to personal financial dealing with clients, some of which are currently set out in the Conduct and Practices Handbook.

In addition to the prohibition against personal financial dealing with clients, the Proposals in Attachment A will codify, in Dealer Member Rule 18.14, IIROC’s current expectations regarding outside business activities by imposing a specific and positive obligation on Registered Representatives and Investment Representatives to:

- disclose any outside business activity to the Dealer Member; and
- obtain the Dealer Member’s approval

before engaging in any outside business activity in order for the Dealer Member to ensure that they are not inappropriate and do not give rise to a conflict of interest. The objective of these amendments is to codify current expectations relating to disclosure and approval of outside business activities.

Issues and specific proposed amendments

I. Personal Financial Dealing with Clients

IIROC Dealer Member Rule 29.1 currently requires Approved Persons and employees of a Dealer Member to observe high standards of ethics. Dealer Member Rule 29.1 also prohibits such persons from engaging in conduct or practice that is unbecoming or detrimental to the public interest. Furthermore, pursuant to National Instrument 31-103 (NI 31-103) *Registration Requirements and Exemptions*, Dealer members are required to take reasonable steps to identify existing and potential material conflicts of interest that the firm reasonably expects to arise between the firm and a client. The Companion Policy of NI 31-103

explains that a firm's policies and procedures for managing conflicts should allow the firm and its staff to, among other things, identify conflicts of interest that should be avoided and to respond appropriately. It is the position of IIROC Staff that any personal financial dealing with a client creates an unacceptable conflict of interest between the Dealer Member's employee or agent and the client. Having said that, the issue of personal financial dealing is not specifically addressed within the current IIROC Dealer Member Rules. The only specific guidance on the matter is set out in the Conduct and Practices Handbook, a handbook used widely within the industry that provides guidance on various ethical and conduct issues.

It is the position of IIROC staff that a specific rule which prohibits personal financial dealing with clients is important to enhancing IIROC's ability to meet its investor protection objective.

The provisions set out in the Proposals will codify IIROC's current expectations with respect to this issue. The Proposals will specifically prohibit Registered Representatives, Investment Representatives, Executives, Supervisors or employees of a Dealer Member from, directly or indirectly, engaging in any personal financial dealing with clients. Furthermore, the proposed Rule will prohibit such individuals from permitting their associates to engage in personal financial dealings with clients. The Proposals set out in Appendix 2 will represent an extension of these general business conduct standards by specifically prohibiting personal financial dealing with clients.

Furthermore, the Proposals will specify that the following types of arrangements, subject to specific exemptions, are considered to be personal financial dealing with a client and subject to the general prohibition set out above:

- **Benefit or other consideration:** We will be introducing new requirements which will specify that receiving any material consideration from any person, other than the through the Dealer Member, for the activity conducted on behalf of a client is deemed to be personal financial dealing with a client. The proposed provision is consistent with current IIROC Dealer Member Rule 18.15 which states that a Registered Representative or Investment Representative may not 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. The Proposals do however, provide for a specific exemption if the consideration is non-monetary, of minimal value and sufficiently infrequent such that it will not cause a reasonable person to question whether it created a conflict of interest. The exemption noted above is consistent with current IIROC expectations relating to gifts that an Approved Person or employee may receive from others, including clients.
- **Private settlement agreements:** The Proposals will also clarify that a private settlement agreement between a client and an Approved Person or employee is considered to be personal financial dealing and is therefore prohibited. Current IIROC Dealer Member Rule 3100 prohibits registrants from entering into any settlement agreement with a customer, without the prior written consent of the Dealer Member. This proposed provision is not a substantive amendment to that rule but rather clarifies that a settlement agreement entered into without the consent of the Dealer Member will be considered personal financial dealing with the client.
- **Borrowing from clients:**

The inappropriateness of borrowing money from clients is not specifically addressed in the IIROC Dealer Member Rules¹ currently. The Proposals will specify that borrowing from clients is deemed to be personal financial dealing and therefore generally prohibited. Having said that, the Proposals do provide specific exemptions under which borrowing from a client will be allowed. These exemptions, which are similar to exemptions used by the Law Society of Upper Canada in their Rules of Professional Conduct, consist of:

- borrowing from a client, whose business includes lending money to the public, if the borrowing is in the normal course of the client's business. The purpose of this exemption is to recognize limited circumstances under which borrowing from a client would not be considered as inappropriate conduct; or
- borrowing from a client who is a Related Person, as defined by the Income Tax Act, as long as the transaction is addressed in accordance with the Dealer Member's policies and procedures.

The latter exemption recognizes that some clients may be related to Approved Persons or employees of a Dealer Member and that such borrowing is appropriate within the context of the personal relationship between the client and the employee or Approved Person. Having said that, in order to effectively identify and address potential conflicts of interest that may arise in these circumstances, Dealer Members need to have policies and procedures to address such borrowing arrangements. The Proposals will expressly require disclosure to and approval of the Dealer Member for any borrowing by a Registered

¹ The inappropriateness of borrowing from client or lending to clients is addressed in the CPH.

Representative or Investment Representative from a client who is a Related Person. In situations where other employees or Approved Persons, such as back office staff, are borrowing from a Related Person, firms may choose to impose less stringent disclosure requirements as there is a lower risk of inappropriate arrangements due to the type and nature of the activity engaged in by such employees and Approved persons.

- **Lending money to clients:** The current IROC Dealer Member Rules do not specifically prohibit Approved Persons from lending money to a client. The Proposals specify that lending to clients is deemed to be personal financial dealing and therefore prohibited, unless:
 - the Approved Person or employee is lending to a client who is a Related Person as defined by the Income Tax Act; and
 - the transaction is executed in accordance with the Dealer Member's policies and procedures.

The rationale and scope of this exemption is the same as the one set out above with respect to borrowing from clients.

- **Power of attorney:** The current Dealer Member Rules prohibit Registered Representatives from having any control over a client's accounts unless that control relates to a Discretionary Account or Managed Account. Discretionary authority over a client's account is similar to having a power of attorney and control over the client's financial affairs. Currently, the inappropriateness of possessing a Power of Attorney or any control or authority over a client's financial affairs is not specifically addressed in the IROC Dealer Member Rules. The Proposals will specify that acting as a power of attorney, trustee, executor or otherwise having full or partial control or authority over the financial affairs of a client is deemed to be personal financial dealing with the client and is, therefore prohibited unless the control or authority is granted pursuant to a managed account or discretionary account arrangement. This proposal is consistent with current IROC expectations and industry practices.

The Proposals will also provide an exemption for situations where the control or authority is exercised over the financial affairs of a client who is a Related Person under the Income Tax Act.

In order to effectively identify and address potential conflicts of interest, each Dealer Member's policies and procedures must include disclosure requirements relating to an employee or Approved Person exercising any power or control over the financial affairs of a client who is a Related Person. The Proposals will expressly require, in addition to the aforementioned disclosure, approval of the Dealer Member for any such control or authority granted to a Registered Representative or Investment Representative by a client who is a Related Person. When such control is exercised by other employees or Approved Persons, such as back office staff, firms may choose to impose less stringent disclosure requirements, as there is a lower risk of inappropriate arrangements due to the type and nature of the activity engaged in by such employees and Approved persons.

II. Other conduct that may be detrimental to the public interest

In addition to the prohibition against personal financial dealing with clients, the following amendments have been proposed in order to clarify that certain activities require disclosure to, and approval by the Dealer Member in order for the Dealer Member to ensure that they are not inappropriate, detrimental to the public interest or such that they would bring the securities industry into disrepute:

- **Outside business activities:** Current IROC Dealer Member Rule 18.14 sets out the conditions under which Registered Representatives and Investment Representatives may obtain or continue in another gainful occupation. The conditions include:
 - i) that the occupation is in compliance with any conditions set out by the applicable provincial securities commission;
 - ii) that the Dealer Member possesses policies and procedures that ensure continuous service to clients and identify and address potential conflicts of interest; and
 - iii) that the occupation is not one that would bring the securities industry into disrepute.

One of the conditions currently included is whether the Registered Representative or Investment Representative is in a remote area. In practice, the "remote area" condition is currently not being used by registrants. Our records indicate that currently there are not any Registered Representatives or Investment Representatives relying on this condition/exemption and that the provision was included based on old practices and/or requirements previously imposed by some securities commissions. Accordingly, IROC staff propose the removal of this provision.

In addition to the requirements set out in Dealer Member Rule 18.14, on November 17, 2006 a notice was issued by the Corporation (MR-0434) which states that any outside employment must be compatible with IIROC Dealer Member Rule 29.1, the requirement that Approved Persons and employees adhere to high standards of ethical conduct, not engage in any activity that is unbecoming or detrimental to the public interest and be of a character and business repute consistent with the foregoing. MR0434 explains that, among other things, in order for the Dealer Member to ensure compliance with Dealer Member Rule 29.1, they must be aware of all other business activities engaged in by the Approved Person and therefore, the firms must have policies and procedures requiring that all other business activities are disclosed to and approved by the firm. The current practice adopted by Dealer Members, in order to manage conflicts of interests, is consistent with the disclosure and approval suggested in MR0434. Furthermore, the current practice is consistent with the requirements set out in NI31-103. In particular, the Companion Policy explains that before approving any outside business activities, the firms should consider potential conflicts of interest and if the firm cannot properly control a potential conflict of interest, then it should not permit the outside activity.

It is the position of IIROC staff that it is important and appropriate to codify the above noted disclosure and approval requirements within the IIROC Dealer Member Rules. In particular, Dealer Member Rule 18.14 is proposed to be amended in order to better align the IIROC requirements with those set out in NI 31-103. The Proposed amendments will require that all outside business activities be disclosed to and approved by the Dealer Member.

Consistent with the current expectation and practices established through National Instrument 33-109 *Registration Information*, particularly the information currently disclosed under item 10 of 33-109F4, IIROC staff propose an amendment to Dealer Member Rule 18.14 which will require disclosure of all outside business activities to IIROC within the time limits set out in the applicable National Instrument. These time limits are currently set out in NI 33-109; a registered individual must notify the regulator within 7 days of the change.

Furthermore, consistent with Dealer Member Rule 18.14 and the expectations and practices that have been created through MR0434, it is proposed that the conditions set out in IIROC Dealer Member Rule 18.14 should not be limited to other gainful occupations. Rather, these conditions would apply to any outside business activity that a Registered Representative or Investment Representative engages in.

MR0434 sets out some approval considerations for Dealer members in determining whether an Approved Person's outside activities should be approved. Dealer Members may continue to use those suggested factors as part of their approval criteria.

The above noted amendments to Dealer Member Rule 18.14 will not have any significant impact on the Dealer Member's operations as it is consistent with the current IIROC expectations and current Dealer Member practices.

Rule-making process

IIROC Staff involved representatives of Dealer Members in the rule development process. A copy of the proposed Personal Financial Dealing Rule was circulated for discussion with the members of the Compliance and Legal Section (CLS) Executive committee. A copy of the same was also made available to all CLS members and presented at the general quarterly CLS meeting for discussion. IIROC staff also circulated for discussion a copy of the amendments to Dealer Member Rule 18.14 to the CLS Executive committee.

A number of changes to the draft proposal were made in response to the comments IIROC received through these consultations.

The Proposals were approved for publication by the IIROC Board of Directors on April 30, 2010.

The text of proposed Rules is set out in Attachment A.

Issues and alternatives considered

Given the importance of these issues in better achieving IIROC's investor protection objective, IIROC staff believe that rule amendments are the only appropriate means of addressing the issues. No other alternatives were considered.

Proposed Rule classification

The purposes of the Proposals are to:

- Prevent fraudulent and manipulative acts and practices;
- Promote just and equitable principles of trade and emphasize the duty to act fairly, honestly and in good faith;
- Foster fair, equitable and ethical business standards and practices; and
- Promote the protection of investors.

It is the position of IIROC staff that the Proposals reflect current IIROC expectations. The Board has determined that the Proposals are not contrary to the public interest.

Due to the extent and substantive nature of the Proposals, they have been classified as Public Comment Rule proposals.

Effects of proposed Rule on market structure, Dealer Members, non-members, competition and costs of compliance

The Proposals will not have any significant effects on Dealer Members or non-Dealer Members, market structure or competition. Furthermore, it is not expected that the Proposed Rules will give rise to any significant, incremental costs of compliance. Rather, the proposed Rules will provide necessary clarity to Dealer Members and registrants regarding personal financial dealing with clients and outside business activities.

The Proposals do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in accordance with IIROC's mandate. The Proposals do not impose costs or restrictions on the activities of market participants that are disproportionate to the goals of the regulatory objectives sought to be realized.

Technological implications and implementation plan

There should not be significant technological implications for Dealer Members as a result of the proposed amendments. The proposed Rule will be implemented upon approval by the recognizing regulators.

Request for public comment

Comments are sought on the Proposals. Comments should be made in writing. Two copies of each comment letter should be delivered within 90 days of the publication of this notice. One copy should be addressed to the attention of:

Sherry Tabesh-Ndreka
Policy Counsel
Investment Industry Regulatory Organization of Canada
Suite 1600, 121 King Street West
Toronto, Ontario
M5H 3T9
stabesh@iiroc.ca

A second copy should be addressed to the attention of:

Manager of Market Regulation
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8
marketregulation@osc.gov.on.ca

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca under the heading "IIROC Rulebook - Dealer Member Rules - Policy Proposals and Comment Letters Received").

Questions may be referred to:

Sherry Tabesh-Ndreka
Policy Counsel, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
416-943-4656
stabesh@iiroc.ca

Attachments

Attachment A - Proposed Personal Financial Dealing Rule and amendments to IIROC Dealer Member Rule 18.14

Proposed Rule "X"**PERSONAL FINANCIAL DEALINGS WITH CLIENTS**

- X.1 A Registered Representative, Investment Representative, Director, Executive, Supervisor, or employee 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.2. Personal financial dealings include the following types of dealings:
- (1) Benefits or other consideration**
 - (i) Accepting any material consideration, including remuneration, gratuity or benefit, from any person other than the Dealer Member for any activities conducted on behalf of a client.
 - (ii) 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.
 - (2) Private settlement agreements**
 - (i) Entering into a private settlement agreement with a client; or
 - (ii) Paying for client account losses out of personal funds without the Dealer Member's written consent.
 - (3) Borrowing from clients**
 - (i) 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 (b) is disclosed to and approved by the Dealer Member.
 - (4) Lending to clients**
 - (i) Lending money, securities or any other assets to a client or incurring any other liabilities for a client, unless:
 - (a) 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
 - (b) In the case of Registered Representatives and Investment Representatives, the arrangement is disclosed to and approved by the Dealer Member.
 - (5) Power of Attorney**
 - (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 account is a discretionary or managed account and the authority exercised is consistent with the Corporation's applicable requirements; or

- (b) 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) In the case of Registered Representatives and Investment Representatives, the arrangement in Paragraph (b) is disclosed to and approved by the Dealer Member.

Amendments to IROC Dealer Member Rule 18.14

Attachment A

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)

~~(i) Either the Registered Representative's or Investment Representative's other gainful occupation is in a remote area where there is no office of a broker or dealer in securities and the Registered Representative's or Investment Representative's activities as such are limited to such remote area in which he or she resides; or (ii) 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 him or her to devote less than his or her full time to the securities business of the Dealer Member employing him or her;~~

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

(d) ~~Any other occupation of the~~ 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;

(d) ~~The Dealer Member notifies the Corporation of the outside business activity within the time period and manner required by the applicable National Instrument; 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 dual employment~~ outside business activity is not contrary to the provisions of the applicable securities legislation or any policy made pursuant thereto.