

# IIROC NOTICE

## Rules Notice

## Guidance Note

### Dealer Member Rules

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**Replaces MR 0434**

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## Disclosure and approval of outside business activities

### 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.<sup>1</sup>

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.

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<sup>1</sup> 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.



- 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.
- 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.

***IIROC Notice 13-0163 – Rule Notice - Guidance Note – Dealer Member Rules – Disclosure and approval of outside business activities***



- 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.
- o 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;

***IIROC Notice 13-0163 – Rule Notice - Guidance Note – Dealer Member Rules – Disclosure and approval of outside business 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 Form 33-109F4 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 its 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.**