

IIROC NOTICE

Rules Notice Request for Comments

Dealer Member Rules

Please distribute internally to:

Credit
Institutional
Internal Audit
Legal and Compliance
Operations
Registration
Retail
Senior Management
Trading Desk

Contact:

Sherry Tabesh-Ndreka
Senior Policy Counsel, Member Regulation Policy
416.943.4656
stabesh@iiroc.ca

14-0103
April 24, 2014

Proposed Personal Financial Dealing amendments

Summary of nature and purpose of proposed Rule

On March 26, 2014, the Board of Directors (the “Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved the publication for comment of proposed amendments to the Personal Financial Dealing Rule (the “PFD rule”) and proposed amendments to Dealer Member Rule 100.15 (collectively the “Proposals”).

The Proposals set out in Attachment A include proposals to:

- clarify the scope of the PFD rule by:
 - (a) moving the specific personal financial dealing prohibitions, currently set out in subsection 43.2, into a new subsection 6 of Rule 42, Conflicts of Interest; and



(b) repealing the general prohibition currently set out in Dealer Member Rule 43.1.

- narrow the scope of the PFD Rule, such that some of the specific prohibited personal financial dealings and related exemptions contained within proposed Rule 42.6 will only apply to Registered Representatives (RR) and Investment Representatives (IR).
- eliminate the requirement for an RR or IR to disclose to, and obtain pre-approval from the Dealer Member in the case of borrowing or lending arrangements with a client who is a Related Person, as defined in the Income Tax Act (Canada).
- allow RRs and IRs to act as a client's trustee or executor, for non-Related Person clients in addition to the existing exemption for Related Person clients, subject to specific conditions such as re-assignment of the account and additional supervisory controls.
- clarify that the prohibition against accepting consideration or benefit from anyone other than the Dealer Member relates to "any business activities" conducted on behalf of a client, rather than "any activities".
- introduce an ancillary amendment to Dealer Member Rule 100.15 for consistency with the PFD rule.
- extend the deadline date for the unwinding of existing trustee, executorship, power of attorney or similar arrangements to June 13, 2015.

Issues and specific proposed amendments

Relevant history

IIROC Dealer Member Rule 43, which relates to personal financial dealing, was approved for implementation by the Board and subsequently by the provincial securities regulatory authorities, to take effect on December 13, 2013, with the exception of arrangements subject to subsection 43.2(5)(i), which were scheduled to take effect on June 13, 2014¹.

Following the publication of the Notice of Approval/Implementation (IIROC Notice 13-0162), some Dealer Members approached IIROC seeking clarification of the scope of the personal

¹ The prohibition from "Acting as a Power of Attorney, trustee, executor, or otherwise having full or partial control or authority over the financial affairs of a client" are set out in paragraph 43.2(5)(i) which, for existing arrangements, were scheduled to come into effect on June 13, 2014.



financial dealing rule (the “PFD Rule”). IROC staff acknowledge that under current Dealer Member Rule 43, some dealings may be unintentionally:

- captured by the general prohibition set out in current section 43.1; and/or
- subject to the requirements of both Dealer Member Rule 43 and Dealer Member Rule 42, Conflicts of Interest.

Current rules

Dealer Member Rule 43 is comprised of:

- A list of specific types of personal financial dealings between an employee or Approved Person of the Dealer Member and clients of the Dealer Member which, subject to certain exemptions, are always prohibited (set out in section 43.2 of the Rule); and
- A general section that prohibits all other types of personal financial dealings with clients (set out in section 43.1 of the Rule).

It is important to note that the phrase “personal financial dealings” was not intended to capture all financial dealings that an employee or Approved Person may engage in from time to time. In light of this, the phrase “personal financial dealing” was not defined in Rule 43 intentionally, in order to give Dealer Members the flexibility to determine whether a proposed financial dealing is a *personal* financial dealing that must be avoided under Rule 43 or is simply a financial dealing that may result in a conflict of interest, in which case the proposed financial dealing must be avoided or addressed in accordance with the requirements of the conflict of interest rules set out in Dealer Member Rule 42.

Proposed rules

1. Proposed Amendments to Dealer Member Rules 42 and 43

In order to address the Dealer Members’ concerns as described above, IIROC staff seek to clarify what financial dealings, other than the specific personal financial dealings listed in section 43.2, fall within the scope of the PFD Rule.

Given that the essence of the PFD Rule is the management of conflicts of interest that flow from such dealings, IIROC staff propose to clarify the scope of the PFD Rule by:



- moving the specific personal financial dealing prohibitions, currently set out in subsection 43.2, into a new subsection 6 of Rule 42, Conflicts of Interest; and
- repealing the general prohibition currently set out in Dealer Member Rule 43.1.

If these proposals are adopted, all personal financial dealings that are not specifically prohibited under the provisions of proposed Rule 42.6 must be assessed by Dealer Members in accordance with the general conflict provisions contained in Dealer Member Rule 42, in order to determine whether the proposed financial dealing must be avoided or can be addressed in a manner that is consistent with the best interests of the affected client(s).

Individuals to Whom Personal Financial Dealing Prohibitions Apply

The scope of the current PFD Rule includes all employees and Approved Persons, including Registered Representatives (RRs) and Investment Representatives (IRs). IIROC staff propose to narrow the scope of the PFD Rule, such that the specific prohibited personal financial dealings and related exemptions contained within proposed Rule 42.6 will only apply to RRs and IRs.

IIROC staff believe that the risks that the PFD Rule is intended to address arise most frequently in cases involving RRs and IRs, given the client-facing nature of the relationship between clients and their RR or IR and the trust that develops in many cases. As such, staff believe that it is appropriate to narrow the scope of the prohibitions and related exemptions, by limiting their application solely to RRs and IRs, rather than all employees and other Approved Persons, without materially impacting the investor protection objective of the PFD rule. Narrowing the rule's scope eliminates the possibility of unintentionally, and unnecessarily, restricting financial dealings between a Dealer Member's unregistered employees or Approved Persons, who are not RRs or IRs, and their friends and family who are clients of the employing Dealer Member. It is important to note however, the narrowing of the rule's scope does not negate the Dealer Member's obligation to assess all proposed financial dealings between a client and anyone acting on the Dealer Member's behalf, which includes all Approved Persons and employees in accordance with the conflict of interest rules set out in Dealer Member Rule 42, as well as section 13.4 of NI 31-103. If, upon completion of that assessment, a conflict is identified, the Dealer Member must determine whether it must be avoided or whether it can be managed. Dealer Members are also free to choose, as a matter of internal firm policy, to simply prohibit all such financial dealings between clients and employees and/or Approved Persons.



IIROC staff recognize that generally, RRs or IRs working for an order execution only (OEO) firm are not “client facing” and do not, therefore, develop the same type of ongoing relationship with their clients that full service RRs or IRs do. However, given the ongoing evolution of the OEO service offering, IIROC staff are hesitant to exclude OEO IRs from the scope of the proposed PFD rule at this time.

Disclosure and approval requirements when the client is a Related Person

Similar to current Dealer Member Rule 43.2, proposed section 42.6 stipulates that RRs and IRs may not borrow from, or lend to a client, nor can they assume any authority over the client’s financial affairs, unless the proposed arrangement is, among other exemptions, with a client that is also a “Related Person”.

Current Rule 43.2 requires that an RR or IR wishing to enter into a financial dealing with a client who is a Related Person must obtain the pre-approval of the Dealer Member.

The proposed amendments will eliminate the requirement for an RR or IR to disclose to, and obtain pre-approval from, the Dealer Member in the case of borrowing or lending arrangements with a client who is a Related Person. IIROC Staff are proposing the elimination of this requirement on the basis that the cost and administrative burden arising from this requirement may be unduly burdensome for some Dealer Members. There is a need to balance the legitimate investor protection concerns against the burden imposed on Dealer Members.

However, it should be noted that IIROC staff are not proposing to eliminate the requirement to disclose and obtain the Dealer Member’s pre-approval in the case of financial authority arrangements (i.e. trustees, executors, powers of attorney) between an RR or IR and a Related Person client. Rather, the proposed amendments will clarify that the disclosure and approval requirement is only applicable when the Related Person client of the RR or IR is also a client of the same RR or IR personally. To require disclosure and approval of such financial authority arrangements for a Related Person client, who is not a personal client of the RR or IR, would create an unnecessary burden.

Control and Authority Appointments

Currently, Dealer Member Rule 43.2(5) prohibits employees and Approved Persons from acting as a client’s Power of Attorney, trustee or executor unless the client is a Related Person



and the arrangement is disclosed to and approved by the Dealer Member prior to the arrangement taking effect.

Concerns have been raised that this prohibition takes away the client's right to choose their advisor as their executor or trustee. Furthermore, some small Dealer Members have expressed concerns that the prohibition unduly favours bank-owned Dealer Members, who have affiliated trust divisions to whom clients can be referred and that it creates an un-level playing field between large and small dealers. Staff acknowledge the competitive impact this prohibition may have on some Dealer Members and does not want to inappropriately restrict client freedom, however, the conflict of interest that such arrangements potentially give rise to must be dealt with.

In response to the concerns raised, in addition to the exception already available for these types of arrangements with a Related Person, IIROC staff are proposing amendments that would allow RRs and IRs to act as a trustee or executor for a client that is not a Related Person, provided that:

- the proposed appointment is disclosed to and pre-approved by the Dealer Member;
- the Dealer Member determines that any existing or potential conflict can be controlled by reassigning the responsibility to provide services to the client, including but not limited to assessing suitability, making investment recommendations and executing the client's trade instructions, to another RR or IR who is independent of the RR or IR who was appointed Executor or Trustee; and
- the Dealer Member has adequate policies and procedures to supervise the account and the activities of the RR/IR who is exercising control or authority, to ensure any existing or potential conflicts of interest are addressed in a fair, equitable and transparent manner.

The requirement to "assign another RR or IR to provide services to the client" is consistent with section 13.4 of the Companion Policy to National Instrument 31-103, which suggests that assignment to another RR or IR is one means of controlling conflicts of interests generally. In order for the Dealer Member to determine if the conflict of interest can be controlled by assigning the client's account to another RR or IR, the Dealer Member must assess the particular circumstances of each proposed arrangement in order to ensure that the new RR or IR exercises independent judgment and will not be influenced by the original RR or IR who has assumed a control position over the client's financial affairs. IIROC staff are of the view that in



order for Dealer Members to demonstrate that the new RR or IR is independent of the RR or IR who has assumed control or authority of the account, the account cannot be assigned in any of the following ways:

- to another RR or IR over whom the original RR or IR has supervisory authority;
- to another RR or IR that operates within the same sales team, or similar structure, as the original RR or IR; or
- to the sales assistant of the RR/IR who has been granted the position of authority.

The condition to have adequate policies and procedures and ensure that conflicts are addressed in a fair, equitable and transparent manner, are consistent with the requirements set out in the general Conflicts of Interest rule, Dealer Member Rule 42.

Staff are of the view that the above noted amendments allowing RRs and IRs to act as a trustee or executor for clients that are not Related Persons will allow investors the right to choose who will act as their executor or trustee. Such an approach will provide Dealer Members with the flexibility to allow such arrangements, thereby addressing the concerns raised by some Dealer Members, while providing sufficient client protection to address any potential risk of harm that may arise as a result of an RR or IR acquiring control or authority over the financial affairs of a client.

IIROC staff are specifically soliciting comments as to:

- whether the level of independence between the RR/IR who is assigned to the account and the RR or IR who was appointed as the trustee or executor, as set out above, are sufficient to address any conflicts of interest issues that may arise; and
- the risk based supervision approach that Dealer Members would implement to ensure proper supervision of such accounts.

It should be noted that the exceptions described above in respect of clients that are not Related Persons are only valid in situations where an IR or RR will be acting as a trustee or executor; the exception does not extend to scenarios in which an RR or IR would be granted a power of attorney or other type of control or authority. The exception does not extend to these scenarios because doing so would allow an RR or IR to exercise control or authority over the financial affairs of a client in a manner that is inconsistent with existing IIROC rules relating to the operation of discretionary and managed accounts. Specifically, current IIROC Dealer Member Rules and related IIROC rules awaiting securities commission approval, do not allow

IIROC Notice 14-0103– Rules Notice – Request for Comments –Dealer Member Rules- Proposed Personal Financial Dealing amendments



RRs or IRs to possess trading authority over a client's account or operate a discretionary account on an on-going basis, as such arrangements would be tantamount to an RR or IR operating a managed account without having to comply with the IIROC requirements relating to proficiency and supervision. In light of these existing requirements, it would be inconsistent to allow an RR or IR to possess a broader scope of authority, such as a power of attorney, over the client's financial affairs.

Accepting consideration from a person other than the Dealer Member

In order to clarify the scope of the proposed rule 42.6 (2) (current Dealer Member Rule 43.2 (1)) in relation to accepting consideration or other benefit from a client, IIROC staff have amended this provision to more clearly state that the prohibition against accepting consideration or benefit from anyone other than the Dealer Member relates to "any business activities" conducted on behalf of a client, rather than "any activities". This proposed amendment addresses concerns raised by Dealer Members suggesting that the scope of the activities captured is broader than intended by IIROC staff.

A copy of the proposed amendments relating to current Dealer Member Rules 43 and 42 are set out in Attachments A and B.

Unwinding of Existing Trustee, Executorship and Power of Attorney Arrangements

Although the effective date for most of Dealer Member Rule 43 was December 13, 2013, an extended deadline of June 13, 2014 was provided to Dealer Members in order to facilitate the unwinding of existing arrangements under which an employee or Approved Person 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.

Given the proposed amendments to:

- (a) narrow the scope of the prohibition relating to the assumption of control or authority positions, such that it only applies to RRs and IRs; and
- (b) provide an exemption that would allow RRs and IRs to act as a non-Related Person's trustee or executor, subject to certain conditions,

The June 13, 2014 deadline is extended by one year to June 13, 2015. This extension is necessary in order to ensure that existing control or authority arrangements are not



unnecessarily unwound in the event that these proposed amendments are ultimately adopted.

2. Ancillary amendments to Dealer Member Rule 100.15

Dealer Member Rule 100.15 sets out conditions under which an employee or Approved Person can provide a guarantee in respect of client accounts for margin lending purposes and conditions under which a client can provide a guarantee in respect of an employee or Approved Person's accounts for margin lending purposes. Dealer Member Rule 100.15 provides an exception from these conditions for "immediate families of such persons". For consistency with the proposed personal financial dealing amendments, IIROC staff propose amending the exception to apply to "Related Persons" rather than "immediate families".

A copy of the proposed amendments relating to Dealer Member Rule 100.15 is set out in Attachments A and B.

Issues and alternatives considered

IIROC staff considered whether the scope of the Personal Financial Dealing Rule would be better clarified by defining "personal financial dealing", through either rule amendments and/or a guidance document. IIROC staff are of the view that there is a material risk in specifically defining "personal financial dealing", as any definition may have the unintended consequence of being either too broad, thereby capturing ordinary and otherwise appropriate dealings, or too narrow, excluding inappropriate dealings. As such, IIROC staff determined that the scope of the rule would be better clarified by relocating the rules relating to personal financial dealings within the existing conflict of interest rules.

Comparison with similar provisions

The MFDA has a general conflict of interest rule as well as a specific rule which prohibits all Approved Persons from accepting or acting upon a general power of attorney or similar authorization from clients, unless the authorization is from the Approved Person's spouse, parent or child.

The CSA has a general conflicts of interest rule, but does not in NI 31-103 or the Companion Policy address the issue of whether POAs and similar authorizations are acceptable or prohibited.

FINRA does not have a general conflict of interest rule.



Proposed Rule classification

Statements have been made elsewhere as to the nature and effects of the proposed rule, as well as analysis. The purposes of the proposed rule are to:

- establish and maintain rules that are necessary or appropriate to govern and regulate all aspects of IIROC's functions and responsibilities as a self-regulatory entity,
- ensure compliance with securities laws,
- promote just and equitable principles of trade and 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.

The Board therefore has determined that the proposed amendments are not contrary to the public interest.

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

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

The amendments allowing RRs and IRs to act as a trustee or executor for clients that are not Related Persons will have a material impact on investors as it will provide the clients with the right to choose who will act as their executor or trustee. These amendments will also have a significant impact on Dealer Members, and in particular small Dealer Members, by allowing them to continue to offer these services to clients. The amendments will also serve to maintain a more level playing field between small Dealer Members and large, bank-owned Dealer Members.

The balance of the amendments will not have any significant effect on Dealer Members or non-Dealer Members in terms of market structure or competition as they simply clarify previously approved rules. Furthermore, it is not expected that the amendments will give rise to any significant, incremental costs of compliance. Rather, the amendments will provide the



necessary clarity to Dealer Members and registrants regarding personal financial dealings with clients.

The amendments do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in accordance with IIROC's mandate. The amendments 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 proposed amendments. Comments should be made in writing. Two copies of each comment letter should be delivered by June 23, 2014 (within 60 days from the publication date of this notice). One copy should be addressed to the attention of:

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

The second copy should be addressed to the attention of:

Manager of Market Regulation
Ontario Securities Commission
19th Floor, Box 55
20 Queen Street West
Toronto, ON 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 Rule Book –Dealer Member Rules – Proposed Policy”).

Questions may be referred to:

Sherry Tabesh-Ndreka
Senior Policy Counsel
416.943.4656
stabesh@iiroc.ca

Attachments

Attachment A – Text of proposed amendments to Dealer Member Rules 42, and 43 and 100.15

Attachment B – Black-lined copy of proposed amendments to Dealer Member Rules 42, 43 and 100.15