

IIROC NOTICE

Rules Notice

Request for Comments

Dealer Member Rules

Please distribute internally to:

Institutional
Internal Audit
Legal and Compliance
Registration
Retail
Senior Management
Training

Contact:

Sherry Tabesh-Ndreka

Senior Policy Counsel

416 943-4656

stabesh@iiroc.ca

11-0150

May 11, 2011

Request for comments on draft Guidance Note “Disclosure and approval of outside business activities”

On May 28, 2010 IIROC issued for public comment its proposed rules regarding personal financial dealing and outside business activities ([IIROC Rules Notice 10-0155](#)). In response to the comments received, IIROC staff has updated its existing guidance on outside business activities (Member Regulation Notice 0434 issued on November 17, 2006 “MR-0434”) and plans to replace MR-0434 with the draft Guidance Note once the proposed rules relating to outside business activities are finalized.

A draft copy of the draft Guidance Note is attached for comment by Dealer Members and other interested parties. Comments should be provided by July 11, 2011, 60 days from the publication date of this request for comments.



The final Guidance Note will be issued along with the final version of the rules on personal financial dealing and outside business activities once the rules have been approved by the Canadian Securities Administrators.

Comments on the updated Guidance Notice may be delivered in writing or by fax or email within 60 days of the date of this notice to:

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Guidance Note- Draft

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Senior Policy Counsel
416 943-4656
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**11-xxxx
xx, 2011**

Disclosure and approval of outside business activities

Background

In November 2006, IIROC issued Member Regulation Notice 0434, *Other Business Activities* (“MR0434”), in order to provide Dealer Members and approved persons with guidance on the issue of business activities engaged in by approved persons but that are not performed on behalf of the Dealer Member. MR0434, among other things, explained that Dealer Members must be aware of all 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.



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 and Exemptions* (“NI 31-103”). **[Note to Draft:** The final amendments to rule 18.14 have not yet been approved by the CSA. The final Guidance Note will be published once CSA has approved the amendments for implementation]

For the purpose of this Guidance Note, outside business activities include any business activity conducted outside of the Dealer Member by an approved person, for which direct or indirect payment or compensation is received or expected, as well as any other activity by which a potential conflict of interest or client confusion may arise. Sitting on the board of any organization is one type of activity which may give rise to potential conflicts of interest.

The amendments codify IIROC expectations that Registered Representatives and Investment Representatives must disclose all outside business activities to their Dealer Member and obtain the approval of the Dealer Member before engaging in any outside business activities. The amendments are in addition to the requirements set out in NI 31-103, which require Dealer Members to take reasonable steps to identify:

- existing material conflicts of interest; and
- material conflicts of interest that a firm, in its reasonable opinion, would expect to arise between the firm, including each individual acting on the firm’s behalf, and a client.

The Companion Policy to NI 31-103 (“CP 31-103”) explains that as part of identifying these conflicts a firm should collect information from the individuals acting on its behalf regarding the conflicts that these individuals expect to arise with their clients. CP 31-103 highlights outside business activities as one example where a conflict of interest could arise.

Dealer Members are also reminded that Form 33-109F4, *Registration of Individuals and Review of Permitted Individuals* (“33-109F4”), requires approved persons to disclose their outside business activities to IIROC.

The recent amendments to IIROC Dealer Member Rules, which prohibit any personal financial dealing with clients, stipulate that receiving any compensation directly from any one 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 for in the case of any compensation received from a client that is in exchange for services provided through an approved outside business activity. **[Note to Draft:** The final rules relating to personal financial dealing with clients have not yet been approved by the CSA. The final Guidance Note will be published once CSA has approved the rule for implementation.]

Please note that CSA members may have specific requirements or prohibitions in relation to outside business activities, including those found in NI 31-103 and the associated Companion Policy.



The requirements to disclose and approve all outside business activities

Pursuant to Dealer Member Rule 18.14(1)(c), all Registered Representatives and Investment Representatives must disclose to, and obtain the approval of, the Dealer Member to engage in any outside business activities.

Furthermore, in order to comply with the requirements of NI 31-103, firms must take reasonable steps to identify existing material conflicts of interest and material conflicts of interest that the firm would reasonably expect to arise between the firm, including each individual acting on behalf of the firm, and a client. Given that conflicts may arise when approved persons are engaged in outside business activities, and in keeping with guidance provided in CP 31-103, firms should ensure that they consider whether potential conflicts of interest may arise out of an approved person's proposed outside business activity before approving any such activity. Furthermore, if the firm concludes that it cannot properly control a potential conflict of interest it should not permit the outside business activity.

As noted above, the outside business activities of all approved persons must be disclosed in accordance with Form 33-109F4.

Additionally, the Dealer Member's pre-approval process must take into consideration the requirement set out in Dealer Member Rule 18.14(1)(e), which states that any outside business activities engaged in by a Registered Representative or Investment Representative must not bring the securities industry into disrepute or be contrary to the provision of any applicable securities legislation.

The conditions set out in 18.14(1)(e) are complementary to Dealer Member Rule 29.1; outside business activities must be compatible with the ethical standards set out in Dealer Member Rule 29.1.

Dealer Members' pre-approval processes must 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 supervision 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. In that regard, 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 compelling evidence of the due diligence performed as part of their outside business activity approval process. The Corporation reserves the right to satisfy itself as to the sufficiency of that evidence.

Some approval considerations relating to outside business activities

Dealer Members have at times expressed an interest in receiving clearly-delineated and prescriptive direction from the Corporation on outside business activities. The evolving complexity of the financial services industry however, necessitates Dealer Members to exercise appropriate due diligence and judgment in light of IIROC's more principle-based approach to its policy setting and enforcement activities. The following are therefore offered as considerations, but do not represent an exhaustive list:

- Outside business activities should not materially impair a Dealer Member's "duty of care" to its clients. Therefore:
 - The amount of time that a Registered Representative or Investment Representative spends on the outside business activity is an important consideration. Outside activities that are likely to disrupt timely client access to their dealer account assets and, where it is part of the service offered, to 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 can otherwise be adequately controlled and/or disclosed. Dealer Members and approved persons are reminded that some conflicts of interest are so fundamentally contrary to another person's or company's interest that controls and/or disclosure cannot effectively address them and they should therefore, be avoided.¹
- 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 that provide other services that may be of interest to the customer. However, that permission does not extend to business activities that are outside the Dealer Member, 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.

¹ CP 31-103 Section 13.4



- Business activities “outside” of the Dealer Member must be clearly seen to be outside the Dealer Member. 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.
- 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 need for up-front approvals and the means by which they may be sought. Furthermore, it would be advisable for Dealer Members to include their approval/disapproval criteria in the foregoing and to consider annual “outside business activity” canvasses of their staff;
 - Dealer Members’ records should include complete supporting evidence regarding its handling of all outside business activities 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 be in keeping with both the letter and spirit of Dealer Member Rules 18.14(1) (e) and 29.1. Therefore:
 - No outside business activity which might cause consumer confusion or reflect poorly on the Dealer Member or the industry should be permitted.

Supervision of outside business activities

In order to comply with the requirements set out in Dealer Member Rules 18.14(1)(e) and 29.1, as well as section 13.4 of NI 31-103, Dealer Members must have policies and procedures that allow them to identify conflicts of interest, determine the level of risk that a conflict raises and respond appropriately to the conflict of interest. Conflicts can be addressed through avoidance, control and/or disclosure. Disclosure and the approval (or disapproval) of outside business activities allows the firm to control any existing or potential conflicts.

Filing Requirements – National Registration Database (“NRD”)

For purposes of 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 to IIROC.



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 or outside business activity as a separate item and therefore, make separate entries addressing all elements below. Please also note that changes to this item must be reported within seven (7) days of the change, pursuant to section 4.1 of National Instrument 33-109 *Registration Information Requirements* (“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. It 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 only required under item 1(3) of Form 33-109F4 if the trade name is used solely 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.

In situations where insurance activities are being conducted through a registered insurance provider or through the firm’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.

The Corporation’s acknowledgement of these notices via NRD does not represent the Corporation’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, the Corporation may request further information following the acknowledgement of the Notice, where deemed necessary.

Dealer Members are reminded that 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. Unpaid social, charitable and/or religious service is generally not considered employment or a business activity and therefore need not be disclosed on NRD. It should be noted however, that this does not extend to situations where an individual sits on the board (or similar body) of any organization, including charities or other social or religious organizations; such situations must be disclosed.

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 other 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.