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Investment Industry Regulatory Organization of Canada
Organisme canadien de réglementation du commerce des valeurs mobilières

IIROC NOTICE

Rules Notice
Guidance Note
Dealer Member Rules

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Limitation of Liability Clauses

As part of our normal course activities, IIROC staff have come across certain limitation of liability or exclusionary clauses in retail client account agreements we consider to be inconsistent with our Dealer Members' (**Dealers**) regulatory obligations. We are publishing our findings and analysis, along with next steps, to provide transparency and clarity to all Dealers.

We encourage Dealers to use this Guidance Note as a self-assessment tool in reviewing their client account agreements for compliance with IIROC requirements.

1. Summary

As noted above, some Dealers' retail client account agreements have limitation of liability or exclusionary clauses that we consider to be inconsistent with the Dealer's regulatory obligations. In particular, certain clauses that we have seen:

- exclude the Dealer's liability for account losses completely (including those caused by the Dealer), and
- relieve the Dealer from its securities law obligations, such as suitability.

2. Scope

This Guidance Note focuses on retail client agreements. Through our normal course activities, we reviewed a number of retail client account agreements from a variety of Dealers, which contained various types of limitation of liability clauses. Some of these clauses raised regulatory concerns.

Unlike retail client agreements, institutional client agreements are generally more commercial in nature and subject to more negotiation between two sophisticated parties, and therefore have not raised the same regulatory concerns. However, while this Guidance Note is not directed at institutional client agreements, Dealers' are reminded that agreements with their institutional clients must still be consistent with their regulatory obligations, including IIROC Consolidated Rule 1400 (**Consolidated Rules**) (discussed in section 3.1).

3. Staff findings and analysis

3.1 Our findings

We have identified several types of clauses we consider contrary to subsection 1402(1)[1] of our Consolidated Rules. In addition, the Ontario Securities Commission (**OSC**) has identified[2] certain types of clauses it considers contrary to the duty to deal fairly, honestly and in good faith with clients in OSC Rule 31-505. Such clauses include:

a) clauses that seek to relieve Dealers from their regulatory obligations (such as suitability), for example:

- *Customer agrees not to hold Dealer responsible for losses incurred through following Dealer's trading recommendations or suggestions or those of its employees, agents or representatives.*

b) clauses which completely waive the Dealer's liability, for example:

- *We shall not be liable to you or any third party for loss or revenue or profits, failure to realize expected profits or savings, missed investment opportunities or other items of*

[1] Section 1402(1) reads: "A Regulated Person (i) in the transaction of business, must observe high standards of ethics and conduct and must act openly and fairly and in accordance with just and equitable principles of trade, and (ii) must not engage in any business conduct that is unbecoming or detrimental to the public interest."

[2] See for example OSC Staff Notice 33-740, OSC Staff Notice 33-747 and *Kingsmont Investment Management Inc. and Paget Arthurlyn Warner*.

economic loss, of any nature whatsoever, or any special, indirect, consequential, exemplary, or incidental damages arising out of the services, however caused, and whether arising under contract, tort (including negligence) or any other theories of liability, even if we have been advised of the possibility of such damages

c) clauses which arbitrarily limit damages (such as limiting them to the fees paid by the client), for example:

- *broker's total liability under the terms of this agreement will not exceed an amount equal to the fees paid by the customer to the broker for the one calendar month in which such damages first occurred*.

3.2 Our analysis

We are of the view that clauses which purport to limit liability, in whole or in part, for losses, including losses resulting from a breach by the Dealer of their obligations under IIROC requirements or securities law, are not appropriate.

We consider any clauses described in section 3.1 of this guidance and those that:

- purport to limit the Dealer's liability
- are inconsistent with Dealer's registrant obligations
- attempts to shift the Dealer's responsibilities to its clients, and
- purport to protect the Dealer and the Registered Representative, Portfolio Manager or Associate Portfolio Manager at the expense of the client

to be violations of Dealers obligations under subsection 1402(1) of our Consolidated Rules.

We also consider clauses which seek to relieve a Dealer of its suitability obligation to be a violation of IIROC suitability requirements in Dealer Member Rule 1300.1(p) and (q)[3] [IIROC Rule 3400].

4. Other observations

4.1 Software malfunctions

We found that several Dealers have clauses that limit liability for technology systems malfunction[4]. We recognize that some circumstances may be beyond the control of the Dealer (e.g. power outages, careless use of systems by clients, etc.). However, where the event is within the Dealer's control, such

[3] To assist readers, we reference applicable IIROC Rules provision (see Notice 19-0144 – *IIROC Dealer Member Plain Language Rule Book Implementation*). Since the plain language rule book is not yet effective, we shaded this reference in grey. The shading will be removed when the plain language rule book is effective.

[4] For example (emphasis ours): "Notwithstanding any other term and condition herein or any other agreement applicable to the account, neither us nor the Information Providers will be liable or responsible for any loss caused, directly or indirectly, by any breach of contract, tort (including negligence), or otherwise, arising out of any interruption of or deficiency in any data, information or other aspect of the Services as a result of any act or omission including without limitation communications or power failure, equipment or **software malfunction**."

as functionality of the online platform or services provided by the Dealer, we consider it inappropriate for the Dealer to unilaterally limit its liability.

If a Dealer has automated, or outsourced[5], certain tasks that relate to their regulatory obligations, they cannot disclaim liability simply on the basis that the process was automated or outsourced. In meeting their regulatory obligations to clients through automated or outsourced systems, Dealers remain responsible for performing system testing and monitoring and conducting due diligence reviews of vendors to which critical functions have been outsourced.

4.2 Gross negligence

Many of the limitation of liability clauses we reviewed used the term "gross negligence" to describe what Dealers are responsible for[6]. We note that the term "gross negligence" is not precisely defined in Canadian jurisprudence and may be unclear to clients. Further, our Consolidated Rules specifically refers to "negligence" (as opposed to "gross negligence") when setting out the conduct which results in a breach of regulatory standards in subsection 1402(1) of our Consolidated Rules. Dealers should consider whether their use of the "gross negligence" term complies with the standards of conduct requirements in our Consolidated Rules.

5. Next Steps

We encourage Dealers to complete a self-assessment of their client agreements and look for clauses that fit into the categories discussed in section 3 above. If a Dealer identifies any inappropriate clauses, we encourage them to rectify any non-compliance and advise their clients of any changes to their account agreements.

When IIROC's Business Conduct Compliance (**BCC**) Staff identify questionable clauses as part of normal course examinations, business model change reviews or new member application review, they will bring them to the Dealer's attention for remediation. Depending on the severity of the issue, BCC Staff may, for example:

- recommend correcting the clauses identified as contrary to subsection 1402(1) of our Consolidated Rules and advising clients of such changes,
- decide to include such clauses as a finding under our Consolidated Rules, or
- in more egregious cases, refer the matter to our Enforcement Staff.

[5] Please refer to Notice 14-0012 – *Outsourcing arrangements* for more information.

[6] For example (emphasis ours): "You further acknowledge that you are responsible for any losses realized on your investments and that neither we nor our advisors are responsible for any decrease in the value of your account or any losses (direct, indirect or consequential) that are realized on your investments, however caused, unless such loss is caused by our **gross negligence** or willful misconduct."

6. Applicable Rules and Guidance

This Guidance Note relates to:

- Consolidated Rule 1400 [IIROC Rule 1400] – *Standards of Conduct*
- Dealer Member Rule 1300 – *Supervision of Accounts* [IIROC Rule 3400 – *Suitability*]
- Notice 14-0012 – *Outsourcing arrangements*