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Managing Conflicts of Interest arising from Soliciting Dealer Arrangements

Executive Summary

This guidance concerns the management of conflicts of interest arising from soliciting dealer arrangements entered into by IIROC Dealer Members (**Dealers**).

The proper management of conflicts of interest, and compliance with IIROC Dealer Member Rule (**DMR**) 42 [Part B of IIROC Rule 3100][1], IIROC's general conflicts-of-interest rule (the **Conflicts Rule**) and related guidance, is a priority for IIROC. Soliciting dealer arrangements raise regulatory concerns about the ability of a Dealer participating in an arrangement to comply with the Conflicts Rule and related guidance.

We believe that in some cases the conflicts of interest arising from these arrangements can be addressed for example by, appropriate policies and procedures. However, there are other arrangements where the conflicts are, in our view, unmanageable and therefore should be avoided. An

[1] In this guidance we have referenced current DMRs. To assist readers, we have also referenced, in shaded brackets, the applicable Plain Language Rule Book (**PLR**) provisions (see Notice 18-0014 - *Re-publication of Proposed IIROC Dealer Member Plain Language Rule Book)* relating to the DMR. Since PLR is not yet effective, we have shaded these references in grey. Upon implementation of PLR, we will remove the applicable DMR and replace it with the bracketed PLR section and delete this footnote.

example of this type of arrangement is one that relates to a contested director election involving fees that are paid only for votes in favour of one-side and /or only if a particular side is successful.

In addition to concerns over compliance with the Conflicts Rule and related guidance, there are broader securities regulatory concerns that Dealers will want to consider when entering into a soliciting dealer arrangement, including those about compliance with Canadian proxy solicitation rules[2]. These are discussed by the Canadian Securities Administrators (**CSA**) in CSA Staff Notice 61-303 and Request for Comment – *Soliciting Dealer Arrangements*.

1. Background

"Soliciting dealer arrangements" generally refer to arrangements entered into between issuers or bidders and one or more Dealers under which the issuer or bidder agrees to pay to the Dealers a fee for each security successfully solicited from security holders to:

(i) vote in connection with a transaction requiring security holder approval
(ii) tender securities in connection with a take-over bid
(iii) participate in a rights offering or exercise rights to redeem or convert securities, or otherwise in connection with corporate transactions to attain the requisite quorum for amendments to documents affecting the rights of security holders.

Securities laws restrict an issuer's ability to communicate with certain beneficial shareholders referred to as objecting beneficial owners (OBOs)[3]. However, OBOs may be contacted by an intermediary – e.g. a Dealer. A soliciting dealer arrangement is a way for issuers to assist security holders in becoming aware of corporate actions. The fees for soliciting dealer arrangements are typically subject to a minimum or maximum. In some cases, the payment of a fee is contingent on a particular outcome.

In addition to the situations described above, soliciting dealer arrangements have also been used in connection with contested director elections[4].

1.1 Conflicts Rule

The Conflicts Rule is a principle-based rule supplemented by guidance. Under that rule and the related guidance, Dealers must address conflicts of interest that, or that could, arise with different business models. For example, the Conflicts Rule requires that all existing or potential material conflicts of interest between a Dealer and a client must be addressed

[2] See National Instrument 51-102 *Continuous Disclosure Obligations*

[3] See National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*

[4] For example, the 2013 proxy contest initiated by JANA partners LLC for Agrium Inc. and the 2017 proxy contest initiated by PointNorth Capital Inc. for Liquor Stores N.S, Ltd.

"in a fair, equitable and transparent manner and considering the best interest of the client or clients"

and those between an Approved Person and a client must be addressed

"in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients".

Further, any existing or potential material conflict of interest that cannot be addressed in this manner must be avoided (emphasis added).

1.2 Other rules

In addition to the Conflicts Rule, Dealers should also consider other rules of general application when addressing conflicts of interest, including:

(i) DMR 38.1 [IIROC Rule 3904] that requires Dealers to establish and maintain a system to supervise their activities reasonably designed to achieve compliance with all applicable laws[5]

(ii) Rule 1402, under IIROC's Consolidated Enforcement, Examination and Approval Rules, which requires Dealers and their representatives to observe high standards of conduct and not to engage in conduct unbecoming

(iii) requirements under Canadian securities legislation that a Dealer deal fairly, honestly and in good faith with its clients.

Dealers should also consider the application of the proxy solicitation rules set out in National Instrument 51-102 – *Continuous Disclosure Obligations* to soliciting dealer arrangements. In particular, Dealers should consider refraining from contacting security holders until security holders have received the applicable disclosure document to avoid potential violations of those rules.

2. Soliciting dealer arrangements and conflicts of interest

Soliciting dealer arrangements can take different forms and arise in different contexts. Some arrangements raise greater regulatory concerns and compliance challenges than others. The following is a discussion of various types of arrangements, the regulatory concerns arising from them and our views on the management of conflicts arising from them.

2.1 Soliciting dealer arrangements in contested director elections

Under the Conflicts Rule, conflicts that cannot be addressed in a fair and transparent manner, consistent with and considering the best interests of the client must be avoided[6]. While it may be possible to address the conflicts of interest arising in some arrangements, generally those that relate to

[5] This includes the requirement under section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that Dealers have controls and supervision in place to manage the risks associated with their business.

[6] See DMR 42.2 and 42.3 [IIROC Rules 3211 and 3212].

a contested director election involving fees that are paid only for votes in favour of one-side and /or only if a particular side is successful raise significant conflicts of interest for a Dealer. These conflicts, in our view, are unmanageable and therefore should be avoided. In these cases, it is unlikely that the Dealer would be able to provide objective advice in light of the fee arrangement and the nature of the information made available in a contested director situation.

Contested director elections are different from other events that require a shareholder vote, for example, merger and acquisition transactions, in that contested elections focus on competing qualitative assessments about an issuer's future business strategy and the ability of each slate of proposed directors to implement the strategy. In this case, there is not the same availability of measureable and quantifiable information for decision-making purposes to provide balance.

2.2 Soliciting dealer arrangements in situations other than contested director elections

One-sided and/or contingent arrangements can arise in situations other than contested director elections some of which may also be contested (e.g. contested plan of arrangement). These types of arrangements can be very fact and context specific, and so Dealers must consider whether they can adequately address the material conflicts of interest in accordance with the Conflicts Rule.

Where a Dealer determines that it is appropriate to address the conflicts of interest arising from an arrangement, other than a contested director election, rather than avoid it, disclosure alone is in our view a generally inadequate mechanism because of its limited, and sometimes contradictory, impact on the client's decision-making process. The Dealer should not only disclose the conflict, but also identify how it has addressed the conflict in the best interest of the client. For example, by a Dealer ensuring that soliciting dealer arrangements are specifically considered in its policies and procedures dealing with:

- the nature of the client – retail or institutional – and the related suitability assessment obligation for the client
- the fee structure of the client's account – for example whether fee based or transaction based
- relationship disclosure information
- annual fee disclosure.

IIROC has issued guidance[7] of general application on managing conflicts of interest that Dealers should also consider in the context of soliciting dealer arrangements.

2.2.1 Nature of Disclosure

When disclosing a conflict concerning a soliciting dealer arrangement, Dealers must ensure that the disclosure is:

- in writing, and provided in a timely manner so the client has sufficient time to make a fully informed decision

[7] For example, IIROC Notice 12-0108 *Client Relationship Model – Guidance* and Notice 16-0068 *Managing Conflicts in the Best Interest of the Client*.

- specific to the arrangement and the conflicts it raises, and provides the client with sufficient information to make an informed decision
- understandable to the client
- prominent, complete, in one place and in plain language[8].

In addition to meeting the minimum standards of written disclosure outlined above, the client-facing representative should also explain the nature of the conflict to the client and, where relevant, confirm that the client has actually read the disclosure.

We expect a Dealer to ensure there is robust disclosure, about any soliciting dealer arrangement it has entered into, in the relevant disclosure document that includes:

- who is paying the fee
- who is receiving the fee
- whether the fee is contingent on the security holder voting in a certain manner and/or a specific outcome occurring
- whether the fee is subject to any minimum or maximum payments and any other conditions.

2.3 Arrangements that are neither one-sided nor contingent on a particular result

Arrangements that are neither one-sided nor contingent on a particular result may not always raise conflicts or regulatory concerns. Dealers should assess and address each such arrangement in accordance with its conflicts of interest management practices that it has in place to ensure compliance with the Conflicts Rule.

2.4 Other matters - Fee Reporting

We remind Dealers that soliciting dealer arrangement fees are subject to the fee disclosure requirements in IIROC rules[9].

[8] Dealers should consider the discussion in IIROC Notice 12-108 on minimum standards that Dealers should follow to ensure adequate disclosure.
[9] See DMR 200.2(g)(ii)(H) [IIROC Rule 3811].

3. Implementation

This Guidance Note is effective immediately.

4. Applicable Rules

This Guidance Note relates to DMR [the following IIROC Rules]:

- 29 – Business Conduct [Part A or IIROC Rule 3100]
- 42 – Conflicts of Interest [Part B of IIROC Rule 3100]
- 200 – Minimum Records [IIROC Rule 3800]
- 1300 – Suitability [IIROC Rule 3400]
- 3500 – Relationship Disclosure [IIROC Rule 3216]