

Summary of Public Comments on Proposed Amendments to MFDA Rule 1.2 (Individual Qualifications)

On June 18, 2015 the British Columbia Securities Commission (“BCSC”) published, for a 90-day public comment period, proposed amendments to MFDA Rule 1.2 (Individual Qualifications).

The public comment period expired on September 16, 2015.

4 submissions were received during the public comment period:

1. Kenmar Associates Investor Education and Protection;
2. Canadian Foundation for Advancement of Investor Rights;
3. Small Investor Protection Association; and
4. Royal Mutual Funds Inc. and Phillips, Hager & North Investment Funds Ltd.

The following is a summary of the comments received, together with the MFDA’s responses.

Comments on Proposed Rule 1.2 (Individual Qualifications)

Education, Training and Experience

One commenter expressed general support for the proposed amendments, in particular the adoption of a general proficiency principle within MFDA Rules, to account for those situations where additional training may be appropriate.

Another commenter expressed the view that, in light of the proliferation of investment products and the growing complexity of both investment products and investor needs, a thorough review of proficiency standards is required for individuals and firms offering advice to retail investors. This commenter noted that this review should include not only MFDA proficiency standards, but also those set by the Canadian Securities Administrators (“CSA”), the Investment Industry Regulatory Organization of Canada (“IIROC”) and other financial service regulators. This commenter also stated that, in addition to increased proficiency standards, a best interest duty must also be imposed upon registrants who provide advice to investors.

MFDA Response

MFDA staff recognizes the need for existing proficiency requirements to keep pace with industry and regulatory developments. As a result, the development of initiatives respecting Member and Approved Person education and proficiency has been established as a key goal under the current MFDA Strategic Plan. Such initiatives include proficiency standards for Approved Persons selling exchange traded funds, and continuing education standards for Approved Persons that will address areas such as product knowledge, practice management, compliance and ethics.

The MFDA has and continues to work with both the CSA and IIROC in the development of industry requirements. Certain suggestions noted in the comments, including the adoption of a best interest standard, are beyond the scope of this proposed Rule amendment.

Outside Activity - General Comments

One commenter expressed support for the proposed clarification around the application and scope of existing obligations under MFDA Rules in respect of outside activities.

Three commenters noted concerns with respect to investor losses resulting from outside activities and in, particular, securities-related outside activity. These commenters noted that outside activities pose serious conflicts of interest, that there continues to be a high incidence of Members that are unaware of the securities-related outside activities of Approved Persons, and that there is still significant non-compliance with existing rules respecting outside activities. In this regard, these commenters recommended that the following fundamental reforms be made to the rules governing outside activities:

- Require Members to conduct reasonably thorough investigations regarding Approved Persons' outside activities and require Members to report unauthorized outside business activities to the MFDA;
- Upon detection, require Members to notify any affected clients and the public about unauthorized outside activities;
- Prohibit the authorization of any activity as an outside business if that activity would be expected to be viewed by clients or by the public as part of the Member's business. Rather, such activity should have to be conducted through the Member;
- Require Members to be liable for harm resulting from the acts and omissions of their Approved Persons through all outside activities except where the Member has reasonably determined that the activity could not be expected to be viewed by clients or the public as being part of the Member's business, has made it clear to its clients that the outside activity is not part of the Member's business, and that the Member will not be responsible for those activities;
- Impose a duty on all registrants to report breaches or suspected breaches of securities regulation with appropriate protections for those who do so;
- Determine whether the MFDA, IIROC and provincial securities regulators should impose requirements that financial firms obtain fidelity or some other form of insurance to protect investors from unauthorized outside activities; and
- Require all approved outside activities to be listed and made publicly available on the National Registration Database ("NRD") and require that database to be made user friendly for investors.

MFDA Response

Certain recommendations suggested by the commenters (e.g. obtaining outside activity insurance, and outside activity reporting on the NRD) are beyond the scope of this project and involve registration issues that would require the input and participation of the CSA. Other recommendations (e.g. requiring Members to conduct thorough investigations and upon

detecting unauthorized activities, requiring Members to notify affected clients and the public) are appropriately addressed in the proposed amendments to Rule 1.2 and MSN-0040 and in Policy No.3 Complaint Handling, Supervisory Investigations and Internal Discipline.

Definition of Outside Activity

One commenter noted that the term “outside activity”, as defined in proposed Rule 1.3.1, could be interpreted differently than an “outside business activity” described in Companion Policy 31-103CP *Registration Requirements and Ongoing Registrant Obligations* and Form 31-109F4 *Registration of Individuals and Review of Permitted Individuals*. This commenter noted that the definition of “outside activities” in proposed MFDA Rule 1.3 requires receipt or expectation of payment, compensation, consideration or some other benefit. This commenter noted that there is no such limitation in the description of outside business activity in 31-103CP which includes any employment and business activities outside the registrant’s sponsoring firm, all director and officer positions and any other equivalent positions held as well as positions of influence whether the registrant receives compensation or not. This commenter recommended that the proposed definition of “outside activity” in proposed MFDA Rule 1.3.1 be harmonized with 31-103CP to avoid potential confusion in the disclosure of outside activities by Approved Persons.

Another commenter expressed the view that the definition of outside activity, as set out under proposed Rule 1.3.1, suggests that activities not involving compensation are not included within the definition. In this regard, the commenter stated that activities should be captured under the definition whether or not the registrant receives compensation.

MFDA Response

The activities subject to proposed MFDA Rule 1.3.1 and requirements under 31-103CP and Form 33-109F4 are consistent. Proposed MFDA Rule 1.3.1 refers to “outside activity” rather than outside “business” activity which is the term used in 31-103CP. MFDA staff adopted this term because it better reflects the broader scope of activities that the Rule is trying to capture, which are activities that are not solely business activities, but any activity that meets the definition, which is in accordance with the description of outside business activity under 31-103CP and Form 33-109F4.

With respect to officer and director positions and positions of influence, the requirements of proposed Rule 1.3.1 apply whether or not there is payment, compensation or consideration received by the Approved Person. Having regard to the regulatory concerns that the Rule is intended to address, MFDA staff believes that the scope of proposed MFDA Rule 1.3.1 is appropriate and aligned with requirements under securities legislation.

Disclosure to Clients of Outside Activity

One commenter, referencing requirements under proposed Rule 1.3.2(e) (Disclosure), noted that it does not support giving discretion to Members and Approved Persons to only disclose outside activities that they believe could be confused with Member business. The commenter noted that clients should be made aware of all outside activities that have been approved by the Member. It was also noted that outside activities that could be confused with Member business should not be

approved. In this regard, the commenter referenced the following text of IIROC Notice 13-0163 (Disclosure and Approval of Outside Business Activities): “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”.

MFDA Response

With respect to disclosure of outside activities to clients, MFDA staff is of the view that the matters raised by the commenter are appropriately addressed under the proposed amendments and existing MFDA Rules. For example, under Rule 2.2.5 (Relationship Disclosure), the Member must, at the time of account opening, provide written disclosure to the client describing the nature of the advisory relationship and the products/services offered by the Member.

In addition, under proposed Rule 1.3.2(e), where the outside activity could be confused with Member business, clear written disclosure must be provided to clients that the outside activity is not the business of the Member and not the responsibility of the Member.

MFDA staff notes that the full text of the provision that the commenter referenced from IIROC Notice 13-0163, reads as follows: “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.” Similarly, proposed MFDA Rule 1.3.2(d) requires that the outside activity must not be such as to bring the MFDA, its Members or the mutual fund industry into disrepute and MSN-0040, as revised, likewise provides that Members should consider the background, history and experience of the others involved with the outside activity.

Many Approved Persons are dually-registered to sell insurance. We do not believe that it would be appropriate to prohibit activity that is conducted under another registration and subject to the jurisdiction of another financial services regulator. MFDA staff is of the view that, in many situations, the possibility of client confusion can be appropriately managed through disclosure requirements, for example, as noted above. In certain circumstances, the potential for client confusion may be significant enough that it rises to the level of a conflict or potential conflict of interest. Members and Approved Persons are required to appropriately consider the particular facts in each case and address such situations in accordance with requirements under MFDA Rule 2.1.4 (Conflicts of Interest).

Financial Planning as an Outside Business Activity

One commenter expressed the view that deleting Rule 1.2.1(c)(vii) and treating financial planning like any other outside business activity is inappropriate in light of the current review by the Expert Panel appointed by the Ontario Ministry of Finance with respect to the regulation of financial planning.

MFDA Response

In conjunction with the proposed deletion of Rule 1.2.1(c)(vii), the MFDA is currently considering Rule proposals that would prohibit Approved Persons from using the title “financial

planner” unless they have appropriate proficiency. As a first step in the Rule development process, MFDA staff developed and published a Consultation Paper respecting standards for use of the title “Financial Planner” (see Bulletin #0656-P). The purpose of the Consultation Paper is to solicit feedback from stakeholders with respect to the MFDA’s proposal. MFDA staff acknowledges that financial planning is a unique activity that warrants particular attention which is why we are addressing this area through a separate policy initiative.

With respect to the initiative being undertaken by the Ontario Ministry of Finance, MFDA staff has participated in consultations with the Ministry and believe we have harmonized objectives. We will consider the output of the Ministry of Finance consultations in the development of future MFDA policy initiatives.

Requirements for Outside Activity

A commenter generally referenced requirements under proposed Rule 1.3.2, noting that the Rule is written in a manner which suggests that the only obligations of Members are to approve the activity and ensure that appropriate disclosure is made to clients. In this regard, the commenter noted that there must be additional requirements respecting:

- Appropriate policies and procedures to ensure that outside activities do not involve activities that are inconsistent with securities legislation and MFDA requirements or that interfere with the individual’s ability to remain current on securities law and product knowledge;
- Ensuring that the CCO is able to properly supervise and monitor the outside activities;
- Maintaining records documenting its supervision of outside activities;
- Ensuring that potential conflicts of interest are identified and appropriate steps are taken to manage those conflicts; and
- Ensuring that the outside activity is consistent with the registrant’s duty to deal fairly, honestly, and in good faith with clients.

MFDA Response

The matters raised by the commenter are already addressed under existing MFDA Rules, the proposed amendments to Rule 1.2, as currently drafted, and the related amendments to MSN-0040. For example, requirements for outside activities, as prescribed under proposed Rule 1.3.2, include the requirement that the outside activity not be prohibited by the MFDA or the securities regulatory authority in the jurisdiction. Requirements under existing MFDA Rules establish general obligations that also apply to outside activities. These include, for example, requirements under MFDA Rule 2.5.7 (Maintenance of Supervisory Review Documentation), Rule 2.1.4 (Conflicts of Interest), Rule 2.1.1 (Standard of Conduct) and Rule 2.10 (Policies and Procedures Manual).

Additional guidance and clarification in respect of requirements under Rule 1.3.2 is set out in forthcoming revisions to MSN-0040. The Notice sets out issues that Members should consider before approving outside activities and includes conflicts of interest, standards of conduct and ability of the Member to supervise.

Comments on MFDA Staff Notice

Ongoing Member Supervisory Obligations

A commenter expressed the view that the Notice should clearly require Member CCO monitoring and supervision of outside activities. In this regard, the commenter indicated that section 7 of the Notice (Ongoing Member Supervisory Obligations) is inconsistent with the following guidance under 31-103 CP: “*ensuring the firm’s chief compliance officer is able to properly supervise and monitor the outside business activities*”.

MFDA Response

MFDA staff is of the view that section 7 of the Notice is consistent with the guidance under 31-103CP. The Notice provides that a Member should evaluate its ability to satisfy supervisory requirements regarding the outside activity. The Notice also provides that Members must monitor the activities of their Approved Persons in relation to compliance with MFDA Rules and applicable securities legislation.

Conflicts of Interest

A commenter stated that the Notice should prescribe the kinds of situations that amount to a conflict of interest that should be avoided and those that can be managed and should also explicitly state that Members must conduct their own investigation when determining if there is a potential or actual conflict of interest.

MFDA Response

As noted, Rule 2.1.4 is intended to function as a rule of general application with respect to the treatment of conflicts. The Rule is meant to provide Members with a broad principle under which specific standards are to be created to resolve and manage the conflicts that Members encounter in the conduct of business. Prescribing specific situations in respect of this matter could encourage the practice of structuring business in a way that is intended to take advantage of technical exclusions while ignoring the general purpose of the rule (i.e. to ensure that conflicts are properly managed with the clients’ best interests in mind).

With respect to approving outside activities, as provided in the Notice, Members should consider issues relating to all potential conflicts of interest that may arise from the Approved Person’s duties as a salesperson and his or her outside activity. This would include consideration of the compensation to be paid under the arrangement, the nature of the relationship between the Approved Person and the outside entity, and any other potential conflicts that are identified. If any such conflict cannot be properly managed, the outside activity must not be permitted.

MFDA staff is developing future guidance to assist Members in these matters and will consider providing examples of outside activities that give rise to a potential or actual conflict of interest.

Member Response to Supervisory Issues

A commenter recommended that Members should be required to immediately notify the MFDA upon the receipt of any information suggesting that the outside activities of an Approved Person may bring the Member or the industry into disrepute. This commenter also indicated that the Notice should require Members to immediately notify the MFDA and securities regulators upon becoming aware of an Approved Person's undisclosed outside activity.

MFDA Response

The matters raised by the commenter are already addressed under MFDA Policy No. 6 Information Reporting Requirements, which includes the requirement that Members report to the MFDA whenever a Member is aware, through a written or verbal complaint or otherwise, that the Member or any current or former Approved Person has or may have contravened any law or regulatory requirement, relating to: (i) theft, fraud, misappropriation, forgery, money laundering, market manipulation, insider trading, misrepresentation, or unauthorized trading; (ii) a breach of client confidentiality; (iii) engaging in securities related business outside of the Member; (iv) engaging in an undeclared occupation outside the Member; or (v) personal financial dealings with a client.

Additional Guidance Requested

Commenters requested guidance with respect of the following:

- Positions of Influence such as a list of principles that should be considered or a non-exhaustive list of roles that are considered positions of influence;
- The appropriate process for monitoring outside activities;
- Examples of “other benefits received or expected” as set out in the definition of “outside activity” in proposed MFDA Rule 1.3.1; and
- Assessing proficiency of Approved Persons to engage in an outside activity.

MFDA Response

MFDA staff will consider the issues noted above in future guidance.

Member Approval of Outside Activity – Standards of Conduct

One commenter expressed concern that the recommendation in the Notice that Members consider the background, history and experience of the others involved in the outside activity extends the duty of Members beyond what is reasonable and puts an obligation on Members to be familiar with and monitor competencies that are unrelated to the Member's own business. The commenter noted as an example that it would be impracticable for Members to control changes to this information or know when their responsibility to consider such factors is met in assessing the outside activity.

MFDA Response

MFDA staff is of the view that a Member's obligation to consider the above noted details is part of a reasonable investigation and part of the suggested practices relating to a Member's general standard of conduct obligations under MFDA Rule 2.1.1.

Disclosure to Clients of Outside Activity

One commenter recommended that notification should be required to be made only to that specific client or group of clients having a connection to the Approved Person's outside activity and should not be required more generally to all clients of the Approved Person. The commenter suggested that the confusion would not arise for clients not impacted by the Approved Person's outside activity.

MFDA Response

MFDA staff is of the view the proposed disclosure is appropriate. As provided in the Notice, with respect to new clients, Approved Persons are expected to provide disclosure at the time the client relationship is established. In addition, where the Approved Person has an existing relationship with a client and the outside activity is a new activity or there is a change to an existing outside activity, written disclosure to the client is required at the time when the Approved Person first engages in the outside activity with the client.

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