

The Canadian Securities Administrators (“CSA”), as part of the Client Focused Reforms (“CFRs”), is implementing the Conflict of Interest provisions effective June 30, 2021.

What does this mean for registrants? How should they be preparing? We will give you some answers.

What are the Conflict of Interest Provisions?

On October 3, 2019, the CSA published amendments to National Instrument 31-103 -- *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“31-103”) and its *Companion Policy* to incorporate the CFRs. The CFRs are designed to enhance the client-registrant relationship and the various provisions will be phased in during 2021.

The self-regulatory organizations, i.e. the Investment Industry Regulatory Organization of Canada (“IIROC”) and the Mutual Fund Dealers Association of Canada (“MFDA”), are in the process of adopting conforming provisions to their rules.

Who do they apply to?

All categories of securities registrant -- dealers (i.e. investment dealer, mutual fund dealer, scholarship plan dealer, exempt market dealer and restricted dealer); advisors (i.e. portfolio manager including restricted portfolio manager); and investment fund managers (N.B. there is limited application to investment fund managers). They also apply to all individuals who are registered with a dealer or adviser.

How is a “conflict of interest” defined?

Generally speaking, a conflict of interest arises when the interests of the client and registrant can be considered to be “inconsistent or divergent”, e.g. situations where the registrant can or may be perceived to be putting its interests ahead of those of the client. It is only “material” conflicts of interest that fall within the CFRs and materiality must be determined by the registrant in the particular circumstance -- factors to be considered are whether the “conflict” could reasonably be expected to affect the decisions of the client and/or the decisions or recommendations of the registrant.

What are the expectations for how a registrant should deal with a material conflict of interest?

Sections 13.4 and 13.4.1 of 31-103 describe how a registrant firm and a registered individual, respectively, must address conflicts. The expectations include:

- 1) Taking reasonable steps to identify current or foreseeable conflicts;
- 2) Addressing any conflict in the best interest of the client; and
- 3) Providing written disclosure of conflicts to clients -- it is noted that disclosure alone is not sufficient to address a conflict.

What does “best interest of the client mean?”

There is no standard definition and a principles-based approach is applied. It involves a determination based on the circumstances and a consideration of the reasonableness of the registrant’s actions in addressing the conflict.

Can you provide examples of possible conflicts?

Internal compensation or incentive programs which favour certain products or services over others can constitute a conflict, e.g. sales or revenue targets. The receipt of any third-party compensation is also problematic. Paid referral arrangements are presumed to be conflicts and they must be addressed by the registrant. While permitted, the recommendation of proprietary products is deemed to be an “inherent” conflict that requires special consideration.

Are there situations not involving trades of securities that can give rise to a conflict?

Having complete control or authority over the financial affairs of a client, e.g. through power of attorney or as trustee/executor. The purchase of assets from a client outside the normal course of business can present a conflict. Outside business activities are also a potential source of conflicts.

If there is a conflict, does that mean we cannot deal with the client or situation?

No, not necessarily. If the conflict can be “managed”, the relationship/trade can proceed.

How do we demonstrate compliance with the conflict of interest provisions?

The “tone from the top” is critical in establishing expectations regarding a high level of integrity in all dealings with clients. An early step is the review of the firm’s current policies and procedures to determine what needs to be revised or developed to comply with the new standards including such things as a description of what a conflict is in order to assist with identifying potential situations, an escalation process for addressing conflicts, regular reporting system to executive management/ board and testing of effectiveness of controls. There is an obligation on the part of the firm to provide compliance training to all appropriate staff including with respect to conflicts (section 11.1(2) of 31-103). Firms are also required to maintain records according to section 11.5(2)(e) of 31-103 in order to show how they have complied with the conflict requirements.

Where can I find the rules and guidances respecting the conflict of interest provisions?

The Press Release announcing the final version of the CFRs, and related links, can be found at:

https://mbsecurities.ca/news/current/cfr_2019.html

The IIROC and MFDA rules are in the process of being implemented but you can review the draft rules at:

https://www.iiroc.ca/Documents/2020/0212672e-b195-40d7-a9a9-e1c045b7b223_en.pdf#search=client%20focused%20reforms

<https://mfda.ca/proposed-regulation/cfr/>

A helpful FAQ was published by the CSA on December 18, 2020:

<https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CFRsFAQsDecember2020FINALEN.pdf>

What should we be doing to ensure we are ready for implementation of the rules by June 30th?

It is important at an early date to establish a timeline and assign the necessary resources to comply with the new requirements. Priorities include the review/development of policies and procedures, provision of internal training programs and creating a communication strategy for clients.

While the conflict of interest provisions come into effect on June 30, 2021, the remaining CFRs have an implementation date of December 31, 2021. Registrants should also be considering how they will meet these requirements.

Pitblado Law is able to assist securities registrants with meeting their regulatory obligations under the CFRs including by providing advice and training as well as drafting policies and communications. Please contact us if you have any questions.

Please do not hesitate to contact me if you have any questions or if I can be of assistance in guiding you through any regulatory obligation issues.

This article was prepared by:

DON MacDONALD
LAWYER
204.956.3519
macdonaldd@pitblado.com



DON MacDONALD
LAWYER
204.956.3519
macdonaldd@pitblado.com

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3