

**Re: IROC response to public comments on draft Guidance Note “Disclosure and approval of outside business activities”**

This summary responds to the three comment letters received on the proposed Guidance Note on disclosure and approval of outside business activities, published for public comment on May 11, 2011. We have considered the comments received and we thank all the commenters for their submissions.

The comments have been summarized and are followed by IROC staff responses to the comments.

**General comments relating to the scope of the notice and the definition of outside business activities**

- One commenter suggests amending the definition of outside business activities by eliminating references to any other activity which may give rise to potential conflict of interest or client confusion; the commenter’s concern is that the proposed definition is capturing a broad range of non-business involvement.
- The same commenter suggests amending the disclosure requirements by eliminating the requirement to disclose the business activities that place an approved person in a position of influence over a potential client.
- The commenter recommends that involvement in non-business outside activity should not be subject to the disclosure, approval, record-keeping and NRD requirements unless the activity is being formally marketed to clients and the number of hours devoted to the activity exceeds 10% of the average of hours worked per week.

***IROC staff response***

The definition of outside business activities and IROC expectations relating to disclosure of outside business activities is consistent with the current requirements set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103). In drafting the proposed definition, IROC staff considered the following:

- Currently, section 13.4 of NI 31-103 requires the identification of not only existing conflicts of interest but also potential conflicts of interest that may arise between an individual acting on a firm’s behalf and a client. Accordingly, any activity that could result in a potential conflict of interest will also have to be identified. Outside business activities are one type of activity from which an existing or potential conflict of interest may arise.
- As per Form 4 of National Instrument 33-109 *Registration Information* (NI 33-109F4), Dealer Members and Approved Persons are required to provide information regarding

all business-related officer or director positions, or any other equivalent position held, whether or not compensation is received. Consistent with the current CSA expectations, IIROC currently expects disclosure of any activity that places an individual in a position of power or influence as part of the outside business activities disclosures.

The IIROC proposed rules, consisting of both those set out in IIROC Rules Notice 10-0155 and those discussed in the relevant proposed Guidance Note (IIROC Rules Notice 11-0150) were drafted for consistency with the above noted requirements. We have however, amended the definition of “outside business activities” in the Guidance Note as follows:

*“Any business activity conducted outside of the Dealer Member by an Approved Person, for which direct or indirect payment, compensation or other consideration or benefit is received or expected”.*

Furthermore, we have clarified that consistent with the requirements and expectations set out by the provincial securities regulators, the principles set out in the Guidance Note equally apply to any other activities by which a potential conflict of interest or client confusion may arise.

- One commenter suggests that compliance with Dealer Member Rules 29.1 and 18.14 are sufficient.

Dealer Members should note that compliance with Dealer Member Rule 29.1 and 18.14 is required and should form part of the Dealer Member’s policies and procedures. However, compliance with these requirements is not an alternative method of complying with the disclosure and approval requirements.

- One commenter states that “our experience with such business activities is negative. Retail investors, particularly seniors, believe they are dealing with the firm and are shocked, when things go wrong, that they are their own”. The commenter believes that there is no benefit to clients for outside business activities and any control that the dealer will have over the conflicts of interest will add costs which will ultimately flow down to the client. The commenter states that managing outside business activities will result in dealer expenses, IIROC monitoring cost, and investor risk. The commenter is concerned that the dealer will not be accountable for any “abuses that the outside business might inflict on the client” and notes that “off book” transactions are nearly always denied.

***IIROC staff response***

The disclosure and approval requirements set out in the proposed rules, the existing requirements set out in NI 31-103 and those best practices set out in the Guidance Note are intended to address the issues raised by the commenter.

The alternative, not allowing any outside business activities, is not appropriate for various

reasons including the fact that an outright ban may impinge on an individual's right to earn a living, given that in some cases an Approved Person may need to have outside employment or business activities to supplement their income. In fact, there are few, if any, industries or professions which ban their members from any and all outside business activities. IIROC staff believes that it is more reasonable to set out conditions and limitations under which an individual may engage in outside business activities. This approach is consistent with the expectations set out by the provincial securities regulators.

- One commenter notes that given the importance of this notice to retail investors IIROC should not depend on written submissions since historically, the number of submissions from industry participants overwhelm the few submissions from retail investors.

***IIROC staff response***

IIROC staff agrees that consultation with investors and industry participants are equally important and that is the basis for which we issued the Guidance Note for a 60 day public comment period; the publication was to allow all interested parties to comment on any relevant proposal. With regards to this specific proposal IIROC received one letter from an industry participant and two letters from investor representatives.

**Comments relating to disclosure and approval of outside business activities:**

- One commenter suggests that Dealer Members be required to disclose the distinction between their business and any approved outside business activity to clients and the public, in accordance with Section 13.4 of NI 31-103 and its Companion Policy 31-103CP. The commenter states that Dealer Members should be liable for all acts and omissions relating to the outside business activities of their representatives unless it is clear that the activity is not part of the Dealer Member's business.

***IIROC staff response***

IIROC staff agrees that outside business activities should be clearly disclosed to clients and such is the purpose of the proposed rules and Guidance Note relating to outside business activities. We have clarified the importance of explaining the distinction between the Dealer Member's business and the outside business activity. The issue of liability is dependent on the facts of any particular case.

- One commenter suggests that proposed IIROC Dealer Member Rule 18.14(e) be amended to include a condition similar to FINRA's Supplementary Material on FINRA rule 3270 which includes the following condition: Upon receipt of a notice of a registrant's outside business activity, the member is expected to consider whether the proposed activity will be viewed by customers or the public as part of the member's business based upon factors such as the

nature of the activity and the manner in which it will be offered. The commenter further suggests that Dealer Members should not permit any activity which might cause consumer confusion.

- Another commenter suggests using an approach similar to that used by FINRA, which does not require disclosure of activities with organizations that are charitable or religious in nature.

***IIROC staff response***

Similar to the FINRA approach, the IIROC Guidance Note clarifies that the risk of client confusion is a factor that should be considered by a Dealer Member when deciding whether to approve an outside business activity request. The Guidance Note also specifically states that “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”. Furthermore, as per CSA Staff Notice 31-326 *Outside business activities*, the risk of client confusion relating to an outside business activity is a factor when assessing a party’s application for registration and continuing fitness for registration.

IIROC staff does not believe that a further rule amendment is necessary, as the issue of client confusion is captured by paragraphs 18.14(e)(i) and (ii)(2).

Any outside business activity that places an Approved Person in a position of influence or conflict of interest over a client or potential client must be disclosed, whether or not it is a paid position. Examples include where an individual has a leadership role in, or sits on the board (or similar body) of, an organization, such as a social, charitable or religious organization.

- One commenter is concerned about the requirement to pre disclose outside business activities particularly with regards to the expectation to disclose activities that would place an Approved Person in a position of influence over a potential client. One example used by the commenter is that in some cases, an Approved Person may not know or remember that he or she has been named an executor of a will. The commenter further explains that a friend or family who may have appointed the approved person as the executor may be considered as a potential client.

***IIROC staff response***

The issues relating to pre-disclosure and assessment of whether an activity places an approved person in a position of influence over a potential client have been addressed above.

With regards to the example used by the commenter, the first issue is whether executorships are acceptable. Assuming that the appointment is not otherwise prohibited, then the Approved Person would remain subject to the applicable disclosure and approval requirements contained in the proposed rules. Having said that, IIROC staff

acknowledges that such disclosure may not be possible in some rare circumstances, for instance, where the Approved Person was not, and could not have been, aware of their appointment.

- One commenter suggested amending the reference to potential clients in the following part of the Guidance Note: “any outside business activity that places an approved person in a position of influence over a client or potential client must be disclosed...” The commenter is concerned that an Approved Person can come into regular contact with what could be described as “potential clients” in any setting outside of work. The commenter suggests changing **potential client** to **future client**.

**IIROC staff response**

The use of potential client, rather than future client, is consistent with the language used by the CSA in NI 31-103. In order to avoid confusion, this term will be retained.

- One commenter suggests that sitting on the board of a charitable, social or other not-for-profit organization is not an activity that is likely, in the ordinary course, to give rise to potential conflicts of interest, given that board decision-making is by definition consensual or majority based rather than directive by a single member. The commenter suggests that requiring such disclosure is an inappropriate invasion of privacy, especially to the extent that the organization relates to any of the 12 groups whose rights are protected under human rights legislation.

**IIROC staff response**

As previously explained on page 1 of this response letter, the expectation to disclose participation on the board of directors of any organization is mandated by the provincial securities regulators. The rules do not prohibit working with any charitable organizations; rather, the requirement is simply to disclose that fact in order to ensure there are no potential conflicts of interest.

- One commenter suggests that Dealer Members should monitor their representatives for unapproved outside business activities and if unapproved activities are detected, they should report any such activities to IIROC.

**IIROC staff response**

As previously mentioned, Dealer Members have an obligation to identify existing and potential material conflicts of interest, including an Approved Person’s outside business activities. Dealer Members are expected to take reasonable steps to identify existing and potential material conflicts of interest.

- One commenter is concerned that the notice does not contain a provision for periodic examinations to validate that the approved conditions are still applicable and points out that the notice suggests annual canvassing of staff.

***IIROC staff response***

Currently, Dealer Members and Approved Persons are required to report any changes to the information contained in an Approved Person's application for registration; information relating to an Approved Person's outside business activities must be disclosed on the application for registration. The annual canvassing works as a periodic examination and it is to ensure that Approved Persons are complying with the above noted requirements.

- One commenter questions how the use of separate email, fax, business cards, etc. would be enforced and what sanctions would be applicable.

***IIROC staff response***

Dealer Members should ensure the use of separate email, fax and business cards for anyone who engages in outside business activities. IIROC would review such procedures during the course of its audit reviewing. Determining what the appropriate sanction for non-compliance would be would depend on the circumstances of the particular case.

- One commenter suggests that "compelling" should be deleted in the following phrase "Dealer Members are reminded that they must be able to provide compelling evidence of the due diligence performed as part of their outside business activity approval process" as it is unclear and unnecessary given that the Corporation reserves the right to satisfy itself as to the sufficiency of that evidence.

***IIROC staff response***

IIROC staff agree and have deleted the word compelling.

**Comments relating to filing on NRD**

- One commenter does not agree that each employment or outside business activity should be set out as a separate item on item 10 of form 33-109F4; the commenter suggests where an individual plays a similar role in a number of affiliate/related/subsidiary companies, they should be set out as one activity in item 10. The commenter would also like the same consideration as that given to insurance activities under item 13, to be given to securities activities with a foreign affiliate.

***IIROC staff response***

The need for detailed information is in order to ensure that both the Dealer Member and the regulators are aware of all the detailed activities carried out by the individuals including activities carried out at a Dealer Member's affiliate/subsidiary/related companies. This is important in order to identify and address regulatory issues, such as conflicts of interest.

In response the issue of multiple entries, this is mandated through NI 33-109F4 as two

different questions/issues are being addressed. Item 10 relates to the individual's current employment, item 13 relates to the individual's registration with another securities or non-securities related organization. IIROC staff would like to note that individuals who have to make such multiple entries under Item 10 and/or Item 13 can copy and paste the required information, so long as it accurately addresses the item.

- The commenter suggests changing the reporting timelines to 10-days, rather than 7 days, for consistency with recent changes to NI33-109.

***IIROC staff response***

The Guidance Note has been updated to clarify that the time frame for reporting has changed from 7 days to 10 days.

- One commenter suggests that the title of the officer approving the outside business activity be entered on NRD.

***IIROC staff response***

The title of the reviewing person can be entered on NRD. Although, not a specific requirement, IIROC staff strongly encourages this practice as such information may be requested in specific cases and would be beneficial if the Dealer Member has this information readily available.

**Other comments:**

- One commenter suggests amending the definition of the securities related activities in Dealer Member Rule 1 and amending IIROC Dealer Member Rules 18.14 and 18.15 to require that all securities related activities be conducted through a Dealer Member.
- One commenter suggests that if all securities related activities were required to occur through the Dealer Member, this would significantly lessen the potential liability of Dealer Members.

***IIROC staff response***

The definition of securities related activities and its application are outside the scope of this proposal and are currently under review as part of a separate project. The commenter's suggestion is an issue that we will be looking at as part of the separate project.

- One commenter expresses concern that firms derive profits based on their reputation and name recognition and that such recognition induces retail investors to deal with their reps outside of the business, therefore, firms should be required to bear the cost of these outside business activities and that such responsibility will provide Dealer Members with strong incentives to police unapproved outside business activities.

***IIROC staff response***

The Guidance Note clearly states that under no circumstances should an outside business activity cause consumer confusion and that the business activities outside of the Dealer Member must be clearly seen to be conducted outside the Dealer Member. Accordingly, any use of the Dealer Member's name to induce investors to deal with an individual's outside business activities should be prohibited. The extent of a Dealer Member's liability and responsibility to bear the cost of any outside business activity would depend on the facts and circumstances of each case.

- One commenter recommends that IIROC and CSA members undertake to determine whether IIROC Dealer Members should be required to obtain insurance to compensate investors for harm caused by their representatives' outside business activities.

Given the current disclosure requirements and practices set out above, it is the position of IIROC staff that requiring insurance, in addition to the current FIB insurance requirements, is not necessary.

- One commenter suggests that a duty be imposed on all registrants to report breaches or suspected breaches of securities regulation.

***IIROC staff response***

Current Dealer Member Rule 3100 requires a registrant to report to the Dealer Member any time her/she believes that they may have violated, among other things, securities legislation. Any additional requirements, such as a requirement to report when another registrant has violated securities legislation, are outside the scope of this project.

- One commenter is concerned about the potential harm of outside business activities to seniors.
- One commenter requests IIROC to provide examples of how to focus on senior related issues.

***IIROC staff response***

In developing rules and guidance notes relating to outside business activities, IIROC staff considered the impact on all types of clients including more vulnerable clients such as seniors. In dealing with vulnerable clients such as seniors, Dealer Members and Registered Representatives should take extra care in disclosing and explaining the distinction between the Dealer Members' business and the outside business activity that the Registered Representative may be involved with. For example, if a Registered Representative proposes to sell an insurance product to a client outside of the Dealer Member, then extra care should be taken to explain that such products are not related to the Dealer Member's business and are sold through a separate entity.

- One commenter suggests that Registered Representatives should employ a mutually agreed upon Investment Policy Statement based on the client's NAAF and financial plan and that this will help investors detect if unsuitable investments from an outside business interest are being promoted.

***IIROC staff response***

The use of Investment Policy Statements is outside the scope of this project.