FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

August 27, 2010

Sherry Tabesh-Ndreka
Policy Counsel
Investment Industry Regulatory Organization of Canada
Suite 1600, 121 King Street West
Toronto, Ontario
M5H 3T9
stabesh@iiroc.ca

Manager, Market Regulation
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8
marketregulation@osc.gov.on.ca

Re: Investment Industry Regulatory Organization of Canada ("IIROC") May 28, 2010 Request For Comment – *Proposed Personal Financial Dealing and Outside Business Activities Proposals*

We are pleased to offer our comments on the *Proposed Personal Financial Dealing and Outside Business Activities Proposals* constituting amendments to IIROC Dealer Member Rule 18.14 and the proposed IIROC Dealer Member Rule "Personal Financial Dealings with Clients" (together, the "**Amendments**"). Thank you for the opportunity to provide these comments.

The Canadian Foundation for Advancement of Investor Rights ("**FAIR Canada**") is an independent non-profit organization dedicated to representing the interests of Canadian investors in the regulation of the investment and securities industry. The mission of FAIR Canada is to be a national voice for investors on investment industry regulation and a catalyst for enhancing the rights of Canadian investors.

FAIR Canada would like to commend IIROC for undertaking this initiative in respect of its regulation of Dealer Members. We believe that the initiative is an important and useful one, that it is timely, and that it is an important step in reducing the potential for conflicts of interest of Dealer Members and will improve the professionalism of investment advisors and Dealer Members. We consider that, as a whole, the amendments strike a reasonable balance between the public interest and Dealer Member interests.

Our comments fall into five areas, and can be summarized as follows:

1. FAIR Canada generally supports the Amendments, which expressly prohibit personal financial dealings with clients.
2. FAIR Canada does not object to the proposed elimination of the "remote area" exception.
3. FAIR Canada supports the proposed codification of MR-0434.
4. FAIR Canada supports the introduction of the Personal Financial Dealing Rule.
5. The proposed Power of Attorney recommendations and rules do not sufficiently protect some client interests.

1. FAIR Canada Supports the Amendments Prohibiting Personal Financial Dealings with Clients

At the heart of the Amendments are updates to the current rules which will *explicitly* ban personal financial dealings with clients of Dealer Members which are problematic in the context of the dealer-client relationship. FAIR Canada has, over the past year, advocated for the introduction of a requirement for dealers and their registered representatives to put their clients' best interests first. We view these Amendments as a positive step toward that standard.

2. The "remote area" exception/exemption

We understand that IIROC staff are proposing to eliminate the "remote area" exception found in Dealer Rule 18.14(1)(a)(i). As the Rules Notice indicates that the exception is not relied upon by any registrants at present, and such registrants will continue to have other exemptive provisions available to them within Dealer Rule 18.14, registrants would appear to be unharmed by the removal of this exception and no harm would be caused to the public by requiring such registrants to rely on existing provisions permitting dual occupations or employments. In addition, the improvement of technology, particularly communications technology, has greatly reduced the remoteness of most "remote" areas.

3. The proposed codification of MR-0434

Similarly, the proposed codification of IIROC's Notice MR-0434 is a reasonable step toward ensuring the clearest possible set of rules for Dealer Members. Leaving important rulings and positions solely within notices or rulings, instead of clearly laid out in rules, creates problems for registrants in attempting to ensure compliance. It also creates problems for the public, both in understanding the obligations of registrants and in dealing with particular situations where registrants may not understand the rules clearly.

Furthermore, we consider the rule itself, requiring Dealer Members to be made aware of, and to approve, the outside business interests of registrants, to be a good one because it helps to properly police the rules and to identify potential issues and problems before they affect a client.

4. The proposed Personal Financial Dealing Rule

We commend IIROC for laying out the Personal Financial Dealing Rule as an attempt to reduce the potential for conflicts of interest between registrants and their clients. This is particularly important not only to protect the interests of clients, but also to protect the interests of registrants and of Dealer Members, to avoid the *appearance* of conflicts of interests, which can damage both the particular interests of registrants and the interest of the investment industry as a whole.

Michael MacDonald, UBC Professor and holder of the Maurice Young Chair in Applied Ethics, offers a concise and precise definition of conflicts of interest which can serve to ground our discussion of the Personal Financial Dealing Rule. Professor MacDonald states that a conflict of interest is:

> a situation in which a person, such as a public official, an employee, or a professional, has a private or personal interest sufficient to appear to influence the objective exercise of his or her official duties.[1]

Rules preventing conflicts of interest are intended to avoid the problem of actual or apparent divided loyalties. This can arise through the duty of loyalty owed by a professional to a client, such as the duty registrants owe to their clients. The prevention of conflicts of interest is, indeed, a hallmark of professionalism. As a hallmark, and as Professor MacDonald notes, the *appearance* of divided loyalties or personal interests is every bit as crucial as any actual action arising from a conflict of interest.

Personal financial dealings with clients can result in divided loyalties or the *appearance* of divided loyalties because the interests of the client as a consumer of a dealer's services can easily become opposed to the dealer's personal financial interests. The canonical example is the lending of money to clients. The dealer's interest in having the loan paid back speedily may be diametrically opposed to the client's interests as an investor. In many circumstances, the interests will be aligned, but it would be very simple for such a situation to turn into one where the dealer's private interest in having his or her loan repaid is opposed to the client's best interests as an investor.

The ideas about avoiding conflicts of interest, and the appearance of conflicts of interest, are fundamental to professionalism in any field, and fundamental to the legal and ethical notions of faith, confidence and trust. These principles, we believe, are fundamental to the dealer system and to the financial system in general.

---

1 Michael MacDonald, "Ethics and Conflict of Interest", retrieved from http://web.archive.org/web/20071103060225/http://www.ethics.ubc.ca/people/mcdonald/conflict.htm.

Reactions to Other Comments

Certain commenters have expressed the idea, with respect to the proposed amendment, that it would be better for IIROC to allow some types of personal financial dealings with clients, but to regulate those financial dealings more stringently. We deal with two of those comments below.

In his comment letter, Paul Hebert of MacDougall, MacDougall and MacTier proposes allowing Investment Advisors to act as liquidator or trustee. We think there are two important points to be made here:

(a) If, as stated, the investment advisor is a "trusted advisor" to the person whose estate is being liquidated, then there is a clear and unequivocal conflict of interest in such situations. A trustee or liquidator must be independent and neutral regarding all interested parties, and furthermore has fiduciary duties to assignees and creditors. The requirement that an investment advisor act as trusted advisor and at the same time as a fiduciary to assignees and creditors raises potential for a conflict of interest.

(b) Mr. Hebert mentions that it would be a "simple matter" for IIROC to put in place rules and procedures to prevent investment advisors from obtaining personal gain from their actions as Liquidators. However, notwithstanding the remaining conflict of interest between principal and assignees, creditors and beneficiaries (as described above), IIROC also does not have expertise in regulating the relationships of liquidators or of trustees. Its expertise is in regulating dealers. IIROC should not be asked to micromanage conflicted relationships in the liquidator or trustee context.

Regarding private settlement agreements, which were defended in Sandor Kerekes's comment letter, these are clearly personal financial dealings. The entire point of preventing *private* settlement agreements is to ensure that registrants' dealings with clients are placed under some modicum of institutional control by allowing them to be reviewed by the Dealer Member – settlement agreements are, we understand, not to be banned.

5. Power of Attorney recommendations and rules

Finally, we would like to address the recommended changes to the rules regarding registrants acting with Powers of Attorney over client affairs. We consider the current rules to be insufficiently protective of some clients' interests. The proposed rules prohibit:

(i) Acting as a power of attorney, trustee, executor or otherwise having full or partial control or authority over the financial affairs of a client, unless:

(a) The account is a discretionary or managed account and the authority exercised is consistent with the Corporation's applicable requirements;

We consider this rule to be insufficient, consistent with our view expressed above that a key element in preventing conflicts of interest is the prevention of the *appearance* of conflicted interests, and not only the prevention of actions against client interests. We therefore consider that the authority granted by such powers of attorney be, to the maximum extent possible, specifically *limited to* the Corporation's applicable requirements. In other words, no registered representative or investment representative should act under a power of attorney over financial affairs of a client unless it is in furtherance of a discretionary or managed account **and the power of attorney specifically limits the power to the affairs directly related to that discretionary or managed account.**

We thank you again for the opportunity to provide our comments and views on the Amendments and welcome the public posting of this submission. We would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282/ ermanno.pascutto@faircanada.ca or Ilana Singer at 416-572-2215/ ilana.singer@faircanada.ca.

Sincerely,

Canadian Foundation for Advancement of Investor Rights