FAIR | Canadian Foundation *for* Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

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Investment Industry Regulatory Organization of Canada
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Dear Ms Winel and Ms Gerhart,

Re: IIROC Notice 19-0177, Rules Notice and Guidance Note ~ Client Account Agreements, October 10, 2019

FAIR Canada is writing to you regarding the above referenced Rules Notice Guidance Note (Notice) issued on October 10, 2019 regarding findings by the Investment Industry Regulatory Organization of Canada (IIROC) that dealer members are using client account agreements with terms that are in violation of IIROC requirements and securities law.

FAIR Canada commends IIROC for having examined this problem. However, FAIR Canada questions why IIROC is treating this by way of a Guidance Note only. We respectfully submit that this conduct by IIROC dealers is egregious and cries out for a stronger regulatory response, including potential disciplinary action. To effectively regulate this misconduct and protect the public, IIROC must hold the offenders accountable for their misconduct. We also question why there is no requirement that dealers provide compensation to clients who may have been harmed as a result of the dealer's reliance on client account agreements that violate IIROC requirements and securities laws.

1. Enforcement Proceedings

Given the description of IIROC's findings provided in the Notice, we cannot understand why there's no announcement of enforcement proceedings being brought by IIROC to impose appropriate disciplinary sanctions on the dealers, and the executives and members of management responsible for the dealers retail client businesses that have used client account agreements that violate IIROC requirements and/or securities laws. Moreover, in the press release from IIROC that accompanied the Guidance Note, Andrew Kriegler, President & Chief Executive Officer of IIROC, is quoted as saying "It is inappropriate for any contractual clause to unreasonably limit or waive a firm's liability of its regulatory obligations to IIROC and to securities laws."

The Notice describes findings by IIROC staff regarding limitation of liability or exclusion of liability clauses in retail client account agreements used by IIROC dealer members that IIROC considers "inconsistent" with regulatory obligations. The offending contractual clauses are identified as clauses that exclude the dealer's liability for account losses completely, including client account losses caused by the dealer, and clauses that relieve the dealer from its obligations to comply with securities law, including clauses that exclude the dealer from their regulatory suitability obligations and duties to their retail clients. Securities laws in Canada specifically prohibit registrants from delegating their suitability obligations and that only permitted clients (as defined by law) can waive their right to a suitability determination. The Notice states that the use of clauses in retail client account agreements that seek to relieve the dealer from its suitability obligations is considered by IIROC to be a violation of IIROC rules that require regulated persons in the transaction of business to observe high standards of ethics and conduct and to act openly and fairly in accordance with just and equitable principles of trade, and prohibit regulated persons from engaging in any business conduct that is unbecoming or detrimental to the public interest. Further the Notice states, the decision of the dealers to use client account agreements with the offending clauses is a violation of Ontario Securities Commission (OSC) Rule 31-105, the duty to deal fairly, honestly and in good faith with clients.

The Notice also states that several dealers client account agreements contained clauses that limit the dealer's liability for systems malfunctions even where the event is within the dealer's control. Dealers cannot disclaim liability for automated or outsourced functions or tasks. IIROC rules and securities law requirements for outsourcing arrangements state that dealers cannot contract out of their regulatory responsibility for performing systems testing and monitoring and for due diligence reviews of vendors to which critical functions are outsourced.

The Notice also states many agreements use the term "gross negligence" to describe conduct for which the dealer is responsible with respect to the dealers suitability obligations when "gross negligence" is not a defined concept of law under Canadian jurisprudence and is contrary to the legal duty of care that is owed by dealers and their representatives to retail clients in the conduct of the dealers business services, as required by IIROC rules and securities laws.

IIROC dealers have intentionally required clients to enter into agreements that contain clauses that relieve the dealer of fundamental investor protection regulatory and legal requirements. This begs the question, why bother having securities laws and regulatory requirements intended to protect investors if dealers simply contract out of these obligations? This is an abuse and undermines the legal system of investor protections established in Canada. It's particularly offensive given the asymmetry of power in the dealer-retail client relationship and the trust that retail clients are compelled to place in dealers in order to manage investments and savings for their homes, their children's education, and their financial security in old age.

Given the seriousness of the violations of IIROC requirements and securities laws, and the potential harm that clients have suffered by having claims for compensation or redress either limited or dismissed due to the defective clauses in the client account agreements, IIROC should be bringing enforcement proceedings in cases where the agreements clearly violate securities requirements and seeking meaningful sanctions against the dealers and their executives who were either aware of the use of these defective agreements, or who should have been aware.

2. Client Communications and New Account Agreements

The instruction in the Notice that all dealers should review and address any such deficiencies in their client account agreements should be made a mandatory directive, rather than merely an encouragement from IIROC that they do so. In addition, there should be clear directive that

corrective action must be completed by the dealers as soon as possible and not later than a fixed date specified by IIROC.

The affected clients should be immediately advised of the problem and the reasons for the need for new agreements. Dealers should be required to notify affected clients of the deficiencies in their account agreements and the need to execute new agreements that fully comply with the dealer's regulatory obligations and with securities laws. It is not satisfactory to just ensure new agreements are compliant.

3. Client Compensation

It is also our view that the dealers should be required to review client complaints during the period when the defective client agreements were being used to see how many clients who had legitimate complaints were not properly compensated based on arguments that relied on the defective agreements. There is no mention in the Guidance Note of the extent of potential harm to clients or of any remedial action to be taken to correct this.

Once again, we commend IIROC for having examined the client agreements used by the dealer members for compliance with securities requirements. We respectfully request your response to the following questions:

1. Why is IIROC addressing this serious matter involving violations of IIROC rules and securities laws and abuse of retail clients by issuing a guidance note that "encourages" dealers to take corrective action?

2. Why are there no enforcement proceedings against the responsible dealers and, the supervisors and executives who were responsible for the dealers retail client business in clear and unambiguous cases?

3. Why is IIROC merely "encouraging" dealers to review and address these serious deficiencies in their client account agreements, rather than issue a mandatory directive requiring dealers to take corrective action by a fixed date that is set and enforceable by IIROC?

4. Why aren't the dealer members required to review client complaints during the period when defective client account agreements were being used to identify and compensate appropriately any clients who had legitimate complaints but who did not receive full compensation for harm due to reliance by the dealer on the defective agreements?

We thank you for this opportunity to share with you our concerns and our views on these matters. We would be pleased to meet to discuss this matter with you further and your responses to our concerns. Please feel free to contact me at 647-256-6691 / douglas.walker@faircanada.ca

Sincerely,

Douglas Walker
Senior Policy Counsel
Canadian Foundation for Advancement of Investor Rights / FAIR Canada