

A.S.C. Notice 19B

Full Service and Discount Brokerage Activities of Securities Dealers in branches of Related Financial Institutions

Principles of Regulation

Preamble

As a result of legislation recently enacted by several provinces and the federal government, a number of financial institutions ("FIs") have, in the past year, invested in existing securities dealers or have incorporated securities dealer subsidiaries. Some of the securities dealers who are related to FIs; ("FI-related dealers") have indicated an interest in setting up securities dealer branches within branches of their related FIs.

The Canadian Securities Administrators ("CSA") have certain regulatory concerns about a FI-related dealer trading securities within branches of its related FI. In an effort to address those regulatory concerns and achieve as much uniformity as possible in dealing with those concerns, a subcommittee of the CSA, consisting of representatives from the securities commission of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia and New Brunswick, considered the issues regarding full service and discount brokerage securities activities of FI-related dealers within branches of their related FIs. Members of the subcommittee have also discussed these issues with representatives of several FIs, several FI-related dealers, self-regulatory organizations ("SROs"), the Canadian Bankers' Association, The Trust Companies Association of Canada and the Office of the Superintendent of Financial Institutions. The subcommittee has reported to the CSA as a whole, which confirmed the positions taken by the subcommittee.

This notice regarding Principles of Regulation outlines those areas where a consensus has been reached on the subject issues by all of the provinces and territories, unless otherwise indicated. At this time, the principles outlined will be implemented by the securities commission of each province and territory by such means as might be appropriate. The CSA subcommittee will continue its work on the subject issues with a view to eventually turning the principles of Regulation into a National Policy Statement.

The Principles of Regulation apply only to FI-related dealers who conduct full service or discount brokerage securities activities in dealer branches situated within branches of their related FIs. For the purposes of the Principles of Regulation, a FI means any financial institution, including a bank, trust company, loan company, insurance company, treasury branch, credit union and caisse populaire, that carries on business through a branch office network. In Quebec, the Confederation des caisses populaires et d'économie Desjardins du Québec will be considered to be a financial institution and each individual caisse populaire will be considered to be a branch of the Confederation. Also, for the purposes of the Principles of Regulation, a dealer is related to a FI if it is a subsidiary or affiliate of the FI or if the FI would

otherwise be a "related issuer" (as defined in ss. 194(l) of the Regulation made under the Securities Act (Ontario)) in respect of the dealer.

In the case of Manitoba, pending development of a policy regarding other FIs, the Principles of Regulation will only apply to dealers related to banks or trust companies who have dealer branches situate within branches of their related banks or trust companies.

FI related dealers will be registrants under the Securities Acts in the provinces or territories in which they operate and will be subject to the relevant legislation and National, Uniform and Local Policies. In many cases FI related dealers will be members of an SRO and subject to SRO rules and accordingly, the Principles of Regulation assume such SRO membership. The securities legislation and SRO rules address certain kinds of self-dealing and conflicts of interest which might arise as a result of the relationship between the FI related dealer and its related FI. The Principles of Regulation set out additional rules which are necessary as a result of FI related dealers conducting securities activities within branches of their related FIs. Many of the rules are designed to address concerns about public confusion and possible resulting financial losses that might occur when risk oriented securities are traded in branches of FIs where the public is generally accustomed to making deposits or investing in products guaranteed by the FI or insured by the Canada Deposit Insurance Corporation ("CDIC") or some other government deposit insurer. Several of the rules are designed to address certain conflicts of interest that may arise. In those provinces and territories which allow a registered person of the FI related dealer to also be employed by the related FI, certain specific restrictions are imposed to deal with potential conflicts of interest. For example, a conflict might arise if a dually employed salesperson is paid on a commission basis in that he would have an incentive to sell securities over other products of the related FI when the other products might be more appropriate for the client. Such a conflict might also arise if a dually employed registered salesperson was permitted to authorize a loan on behalf of the FI so that a client could buy securities from the salesperson acting on behalf of the FI related dealer.

Although not specifically addressed in the Principles of Regulation, the CSA has concerns about public confusion and conflicts of interest that may arise as a result of FI related dealers trading the following securities in branches of their related FIs:

- (i) securities issued by their related FIs;
- (ii) securities owned by their related FIs; and
- (iii) securities which may also be sold by their related FIs.

The CSA has instructed its subcommittee to further consider these issues and consult with appropriate industry groups before deciding on principles of regulation which are necessary to deal with those concerns.

In the course of the subcommittee's deliberations it became apparent that allowing dealers to conduct full

service or discount brokerage securities activities in dealer branches located in branches of their related FIs raises a number of regulatory concerns for which no clear answers exist. Accordingly, in areas of uncertainty, the CSA has adopted a generally cautious approach, with a view to revisiting these issues in the future after the public, FIs, FI related dealers and regulators have had more experience regarding full service and discount brokerage securities activities conducted in branches of FIs. While any particular issue could be reviewed in a shorter time frame, the CSA is of the view that the Principles of Regulation and any resulting National Policy Statement should be reviewed in no later than three years time to assess whether they adequately serve legitimate regulatory and business concerns.

The Principles of Regulation are designed to address issues raised by specific networking applications made by several FI related dealers to conduct full service and discount brokerage securities activities within branches of their related FIs. Other FI related dealers who enter into similar arrangements with their related FIs will, in the first instance, be required to comply with the Principles of Regulation. The CSA recognizes that variations may have to be made to the Principles of Regulation to address issues raised by other FI related dealers who may wish to conduct securities activities within branches of their related FIs.

Principles of Regulation

1. General

FI related dealers will be permitted to conduct full service or discount brokerage securities activities in dealer branches situate within branches of their related FIs, subject to complying with all relevant FI legislation, securities legislation and policies, SRO by-laws and rules and the principles of Regulation set out herein.

A FI related dealer planning to conduct full service or discount brokerage securities activities in dealer branches situate within branches of its related FI shall provide notice of its plans to the securities commission in each province or territory where such activities will be carried on and obtain the consent of the relevant securities commission or commissions before proceeding to commence such activities.

2. Separation of Premises and Activities

The FI related dealer shall have identifiably separate premises, under the name of the FI related dealer, within the branch of the related FI so that it is clear to the public that the operations of the FI related dealer are separate and distinct from the operations of the related FI.

In a branch of a FI where the FI related dealer has established separated premises, the FI related dealer must not conduct any of its securities activities on the separated premises of the related FI, other than the activities referred to in paragraph 6(a) or (b) (the other activities referred to in paragraph 6 may only be conducted on the separated premises of the FI related dealer in that

branch of the FI). The related FI must not conduct any of its FI activities on the separated premises of the FI related dealer. These restrictions must be adhered to in all provinces and territories, including those which permit registered persons of the FI related dealer to also be employed by the related FI (see paragraph 5). For example, a dually employed salesman of the FI related dealer must not, while standing at one of the counters of the related FI, take orders from clients to buy securities through the FI related dealer. Similarly, a dually employed salesman of the FI related dealer must not, in his capacity as an employee of the related FI, open a FI savings account for a client while on the separated premises of the FI related dealer.

The FI related dealer must have a telephone number which is different from and is listed separately from that of the related FI.

3. Disclosure

The FI related dealer shall make disclosure to the following effect to each client by way of a separate document which shall be delivered to each client before any trading is done for the account of the client:

- (a) The FI related dealer is a separate corporate entity from the related FI;
- (b) moneys held by the FI related dealer in securities accounts are not insured by CDIC or by any other government deposit insurer; and
- (c) unless, with respect to a particular security, the FI related dealer informs the client to the contrary,
 - (i) securities sold by the FI related dealer are not insured by CDIC or by any other government deposit insurer;
 - (ii) securities sold by the FI related dealer are not guaranteed by the related FI; and
 - (iii) values of securities sold by the FI related dealer are subject to market fluctuations.

The FI related dealer must- make such further disclosure of the foregoing matters as is necessary so that its clients continue to be aware of those matters. This might include sending regular disclosure statements to all clients and the use of a sign disclosing those matters prominently displayed on the premises of the FI related dealer.

4. Solicitation of Clients

Registered persons and other employees of the FI related dealer must not actively solicit business from customers of the related FI who enter the FI for the purpose of conducting business with the FI. For example, such person should not solicit customers who are waiting in the teller line to buy securities from the FI related dealer. This does not prevent a FI related dealer from advertising its services and products, as permitted by these Principles of Regulation, within branches of the related FI

5. Dual or Sole Employment

(a) Quebec, Ontario, Manitoba, Saskatchewan, Yukon and Northwest Territories

A registered person of the FI related dealer may also be employed by the related FI and conduct FI activities on the premises of the related FI, provided that such dual employment is permitted by the legislation governing the FI. However, in that case, the FI related dealer must comply with the following:

- (i) a dually employed registered person shall be paid on a salary only basis (this would preclude any form of compensation, including bonus payments, linked to the volume of sales of securities services or products);
- (ii) a dually employed registered person shall not act on behalf of the related FI in lending money to a client for the purpose of purchasing securities services or products from the same such person acting on behalf of the FI related dealer; and
- (iii) the FI related dealer shall adopt and implement rules and supervisory procedures to prevent other conflicts of interest from arising due to dual employment.

If a FI related dealer wants to implement a component of performance-based compensation for dually employed registered persons it should raise the matter with the relevant securities commissions to determine if the conflict of interest concerns, such as those referred to in the preamble, can be satisfied in some other manner.

A registered person of a FI related dealer who does not conduct any FI activities on behalf of the related FI may be paid on a commission basis.

(b) Newfoundland, Prince Edward Island,
New Brunswick, Nova Scotia, Alberta and British Columbia

Registered persons of a FI related dealer will not be allowed to also conduct FI activities on behalf of the related FI. Such persons may be paid on a commission basis.

The Securities Commission of Nova Scotia is giving further consideration to this issue and will release a separate notice at a later date if it decides to alter its position.

6. Securities Activities in Non-Registered Branches

In accordance with securities legislation of the provinces and territories, non-registered FI personnel are not permitted to engage in activities which constitute trading in securities, other than those with respect to which an exemption from registration exists under the relevant Securities Acts, Regulations and rulings.

The FI related dealer will be permitted to conduct the following activities through branches of the related FI in which there are no registered persons of the FI related dealer:

- (a) advertise the services and products of the FI related dealer, subject to 6.2 below, through such means as posters, brochures and other informational materials;
- (b) advertise the fact that specific securities are available for sale through the FI related dealer, provided that the advertising only refers to matters such as the identity of the security, the price of the security and the name and address of the dealer from whom the security may be purchased and does not elaborate on the merits or substance of the security;
- (c) deliver or receive securities to or from clients;
- (d) distribute securities account opening application forms, provided that
 - (i) if assistance is given to a client in completing the form, it is given by a registered person of the FI related dealer or by the manager, assistant manager or credit officer in the branch of the related FI who possesses a high degree of knowledge about the client's financial affairs (in branches where there are registered persons of the FI dealer, assistance in completing the form should only be given by a registered person of the FI related dealer), and
 - (ii) before the FI related dealer conducts any trades on behalf of a client, the completed form is approved by an appropriate registered person of the FI related dealer who is responsible for approving the opening of new accounts and ensuring that the know your client and suitability obligations under the applicable securities legislation have been satisfied;
- (e) receive completed account opening application forms to forward to an appropriate registered person of the FI related dealer for approval; and

- (f) install a toll-free line to the FI related dealer, provided that
 - (i) in British Columbia, Alberta, Manitoba and Ontario, calls made on the toll-free line during normal business hours are handled by an individual registered and resident in the province from which the call originates, while calls made after normal business hours may be handled by an individual who is registered but not necessarily resident in the province from which the call originates;
 - (ii) in Saskatchewan and Quebec, all calls made on the toll-free line are handled by an individual registered and resident in the province from which the call originates; and
 - (iii) in New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland, the Yukon and the Northwest Territories, calls made on the toll-free line may be handled by an individual registered but not necessarily resident in the province or territory from which the call originates that the FI related dealer also employs registered persons who are resident in the province or territory.

The FI related dealer will not be permitted to conduct any of its other activities through branches of the related FI in which there are no registered persons of the FI related dealer, including:

- (a) distributing prospectuses; and
- (b) distributing or assisting clients in completing order forms for securities.

Nothing in paragraph 6 is intended to restrict

- (a) a related FI from trading in securities which the FI is otherwise permitted to do itself; or
- (b) a FI related dealer from trading in securities which the FI related dealer would be permitted to do without being subject to registration under the relevant Securities Acts, Regulations and rulings.

Reference

B. C.	-	Andrew Walker (604) 660-4800
Alberta	-	Walter Kunicki (403) 427-5201
Sask.	-	Barbara Shourounis (306) 787-5842
Manitoba	-	Tom Tapley (204) 945-2548
Ontario	-	Jamie Scarlett (416) 593-8211
	-	Joan Smart (416) 593-3666

Quebec	-	Pierre Lize (514) 873-5326
N.S.	-	Nick Pittas (902) 424-7768
N.B.	-	Donne Smith (506) 658-2504
P.E.I.	-	Merrill Wigginton (902) 368-4563
Nfld.	-	George Kennedy (709) 576-3316
Yukon	-	Malcolm Florence (403) 667-5225
N. W. T.	-	Gerald Stang (403) 873-7490

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