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Client Focused Reforms

Overview of registrants’ conflicts of interest practices and additional guidance

Registrant Oversight

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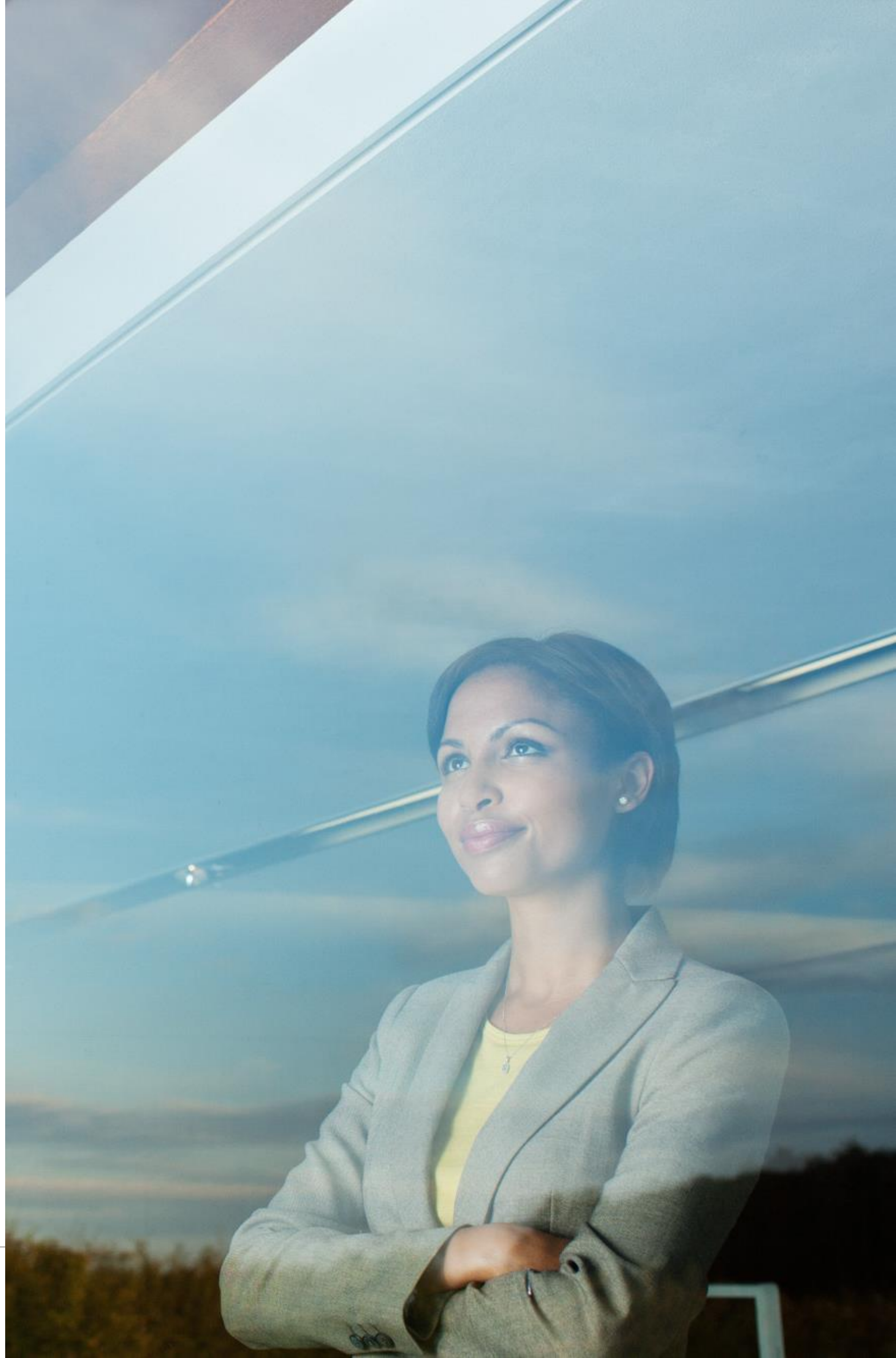
The CFRs, which came into force in two stages in 2021, introduced significant enhancements to registrant conduct obligations



CFRs conflict of interest requirements (effective June 30, 2021)

- Registrants must take reasonable steps to identify existing and reasonably foreseeable material conflicts of interest
- Registrants must address material conflicts in the best interest of clients
- If there is no way to address a material conflict of interest in the best interest of clients using controls, that conflict must be avoided

Identifying material conflicts of interest

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We expect registrants to identify any circumstances where:

- the interests of a client and the registrant are inconsistent or divergent
- they may be influenced to put their interests ahead of their client's interests
- a reasonable client's trust in the registrant may be compromised

Conflicts of interest identified in registrant reviews and controls used by registrants to address these conflicts

Conflicts arising from third-party compensation

- Commissions paid to the firm and dealing representatives
- Issuer payments to firms and affiliated individuals:
    - due diligence review fees
- Performance-based payments (e.g. after investor-preferred returns)

Controls

- Ensuring and clearly documenting how securities that provide third-party compensation are aligned with client interests
- Not solely tying compensation to commission revenue
- Monitoring registered individuals’ recommendations to clients
- Imposing penalties for registered individual non-compliance with policies
- Performing robust know-your-product processes that include evaluating competitive alternatives on an ongoing basis

Conflicts arising from proprietary products

- Not identifying, addressing and disclosing the sale of proprietary products as a material conflict of interest
- Sole reliance on disclosure without any controls for this conflict beyond suitability determinations
- Not providing updated “post-CFR” disclosure to clients, or disclosure not reflective of actual controls
- Not disclosing that the firm only sells proprietary products
- Not updating the policies and procedures manual to set out conflict controls

Controls for firms that only trade in or recommend proprietary products

- Clearly documenting how proprietary products are aligned with clients' interests
- Providing clear disclosure that only proprietary products will be included in client portfolios
- Conducting periodic due diligence and evaluating whether proprietary products are competitive with alternatives available in the market
- Engaging independent parties to evaluate effectiveness of controls

Controls for firms that trade in or recommend proprietary products in addition to non-proprietary products

- Prohibiting benefits that could bias suitability recommendations
- Ensuring that proprietary products are subject to the same KYP processes, and ongoing monitoring, as non-proprietary products
- Making non-proprietary products easily accessible for registered individuals and clients
- Monitoring the level of proprietary products in client portfolios and/or trades
- Clearly disclosing the extent to which proprietary products are included on the firm's product shelf

Conflicts arising from different fees charged to clients

- When the same, or substantially the same, products and services are offered:
  - Select clients allowed to negotiate management fees while other clients are charged standard fees without being given an opportunity to negotiate
  - New clients are given lower fees or other discounts while legacy clients continue to be charged higher fees
- Dealers charge different spreads and commissions for trades in the same product

Controls

- Setting standard fee schedules that are based on measurable criteria:
    - assets under management or trade size
    - types of products offered to the client
    - level of service provided to the client
- Requiring prior approval from the firm’s chief compliance officer or senior management for changes to the standard fee schedule
- Disclosing to all clients and describing the circumstances under which the firm is prepared to negotiate fees

Conflicts arising from director positions with issuers

- Registered individuals who serve on the board of directors of an issuer that is an investee company of a managed fund, or an issuer that is distributed by the firm:
  - nominee directors owe a fiduciary duty to the issuer on whose board they serve
  - must also address all material conflicts of interest in the best interest of their clients (i.e. the managed fund)

Controls

- Restricting the compensation that nominee directors may accept
- Providing clear disclosure to firm clients that a potential conflict of interest may exist
- Establishing ethical walls regarding investment decision-making
- In addition to applicable corporate law restrictions, the nominee director may be required to abstain from voting on contracts or transactions involving the investee company
- Requiring that nominee directors resign from the board of an investee company when conflicts of interest cannot be addressed in the best interest of clients

Conflicts related to referral arrangements

- Payments made for inbound referrals and payments received for outbound referrals may influence a registrant
- Referrals made or received must consider the client’s best interests
- Referred clients must not be charged higher fees for receiving the same, or substantially the same, products and services
- Inbound referrals may give rise to a material conflict of interest depending on the circumstances:
    - business model
    - amount of revenue

Controls

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Inbound referrals

- Ensuring that referred and non-referred clients are treated fairly
- Overseeing the activities conducted by referral agents to ensure that all registrable activities are done by the firm
- Providing training and pre-approved marketing materials to external referral agents
- Conducting ongoing compliance calls to referred investors
- Verifying that additional services provided by the referral agent (e.g. insurance or financial planning) are being performed before submitting associated payments

Controls

Outbound referrals

- Annual questionnaires and interviews for registered individuals receiving referral fees to assess their involvement in referral arrangements
- Ongoing assessment of compensation received by registered individuals
- Monitoring and assessing complaints

Conflicts arising from trades alongside clients – exempt market

- Firms, principals or affiliates of the firm, and dealing representatives investing in securities of issuers that are distributed to clients:
  - terms and pricing of securities are more favourable from those available to clients
  - limited availability or small offering size
  - limited availability or priority of redemptions

Controls

- For limited offerings, the firm and related parties or individuals must not be allowed to trade in the issuer's securities until all client orders are fulfilled
- For issuers limiting redemptions, the firm and related parties or individuals must not be allowed to redeem their own securities before all affected clients are informed and given the opportunity to redeem

Conflicts of interest related to gifts/entertainment

- Unclear policies and procedures and guidance to registered individuals on:
    - what constitutes an unacceptable gift or entertainment
    - reporting of gifts and entertainment to supervisory staff for review and approval
    - books and records to be maintained for gifts and entertainment received or provided by the firm and its registered individuals

Controls

- Maintaining a log of all gifts / entertainment provided and received
- Monitoring the gifts / entertainment log on an ongoing basis
- Implementing clear guidelines and limits on what the firm considers to be a reasonable value for the receipt or provision of gifts / entertainment
- Prohibiting the receipt or provision of monetary gifts or gifts / entertainment that exceed a nominal value
- Setting out an approval and review process for gifts / entertainment

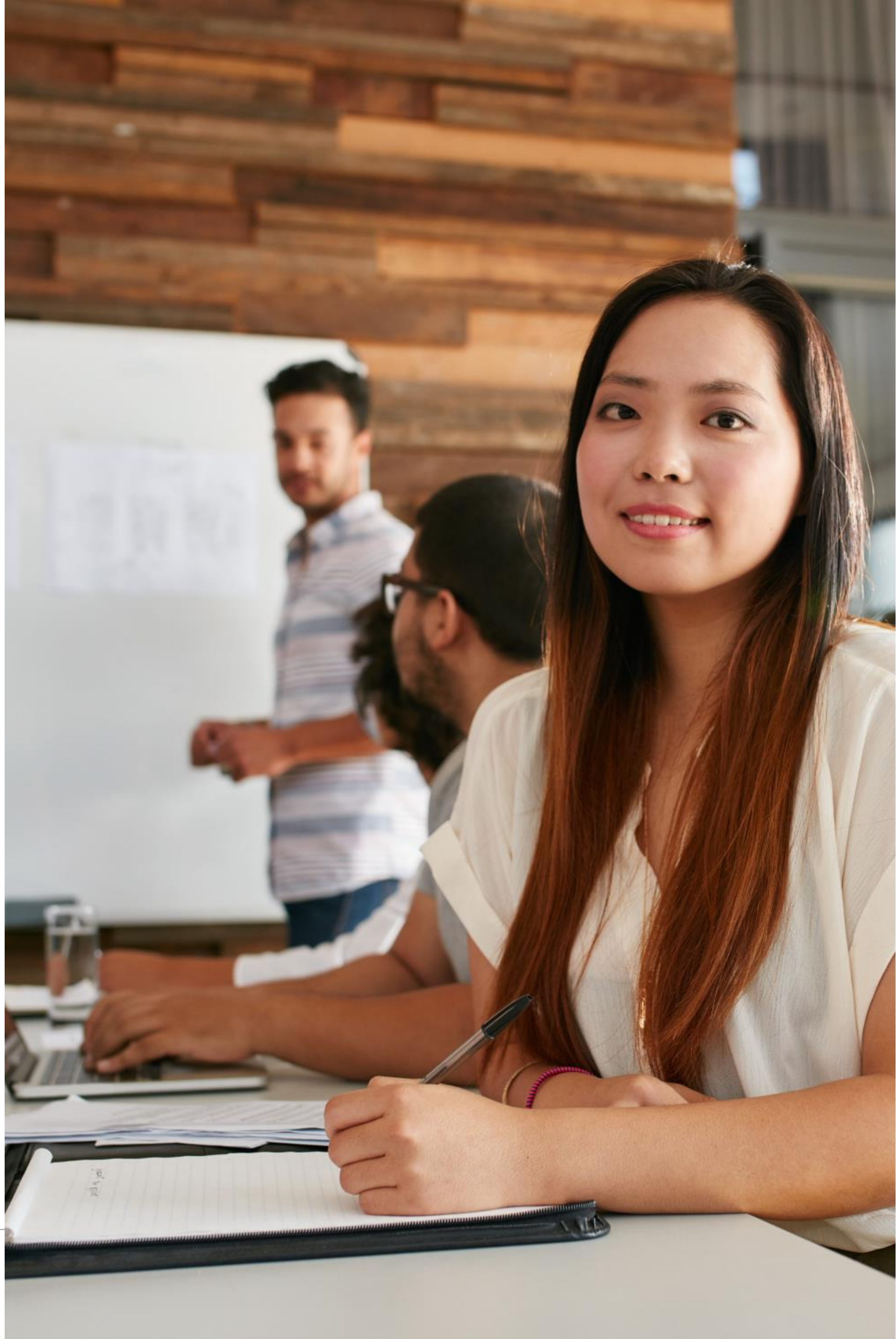
Conflicts arising from managing prospectus exempt funds and proprietary issuers

- Exempt market dealers that act as investment fund managers and portfolio managers for funds they distribute
- Exempt market dealers that distribute related party issuers
- Material conflicts of interest may arise in respect of the:
  - calculations of net asset value or the price of issuer securities, particularly in relation to purchases and redemptions
  - calculations of management and performance fees
  - allocation of expenses and other costs amongst issuers managed by the firm or a related party

Controls

- Engaging independent and qualified parties to calculate or verify valuations and management / performance fees
- Identifying instances when purchases and / or redemptions must not be processed
- Setting out criteria for sharing expenses amongst issuers managed by the firm

Conflicts of interest, internal controls and disclosure



Inadequate conflicts of interest policies and procedures

- Policies and procedures manuals that do not set out:
  - the definition of material conflicts of interest or criteria to determine the materiality of conflicts
  - processes used by the firm to identify conflicts on an ongoing basis
  - the responsibilities and reporting process for registered individuals
  - processes and criteria used by the firm to address material conflicts of interest in the best interest of clients
  - Training procedures for registered individuals and employees

Missing or incomplete disclosure of material conflicts of interest

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- No updates to pre-CFR conflicts of interest disclosure
- No disclosure of:
  - the potential impact and risk of material conflicts of interest
  - how the firm has addressed material conflicts of interest
- Incomplete disclosure only covering select conflicts of interest

Controls

- Disclosing each element in a clear and concise manner
- Not relying on issuer-prepared disclosure
- Considering a reasonable client’s expectations
- Providing disclosure in a timely manner

Conflicts of interest record keeping obligations

- Document the identification, review and analysis of conflicts of interest and their materiality, and how material conflicts have been addressed
- Exercise professional judgment on the level of details recorded – as materiality rises, the level of detail must increase
- Maintain records on:
  - sales practices
  - compensation arrangements and incentive practices

Controls

- Maintaining a conflicts inventory that documents:
    - the materiality assessment and the criteria considered
    - the controls to manage or address each material conflict of interest in the best interest of clients
- Document periodic reviews of conflicts and testing of controls

Questions

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Thank You

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