

Conflicts of Interest



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Background and Importance

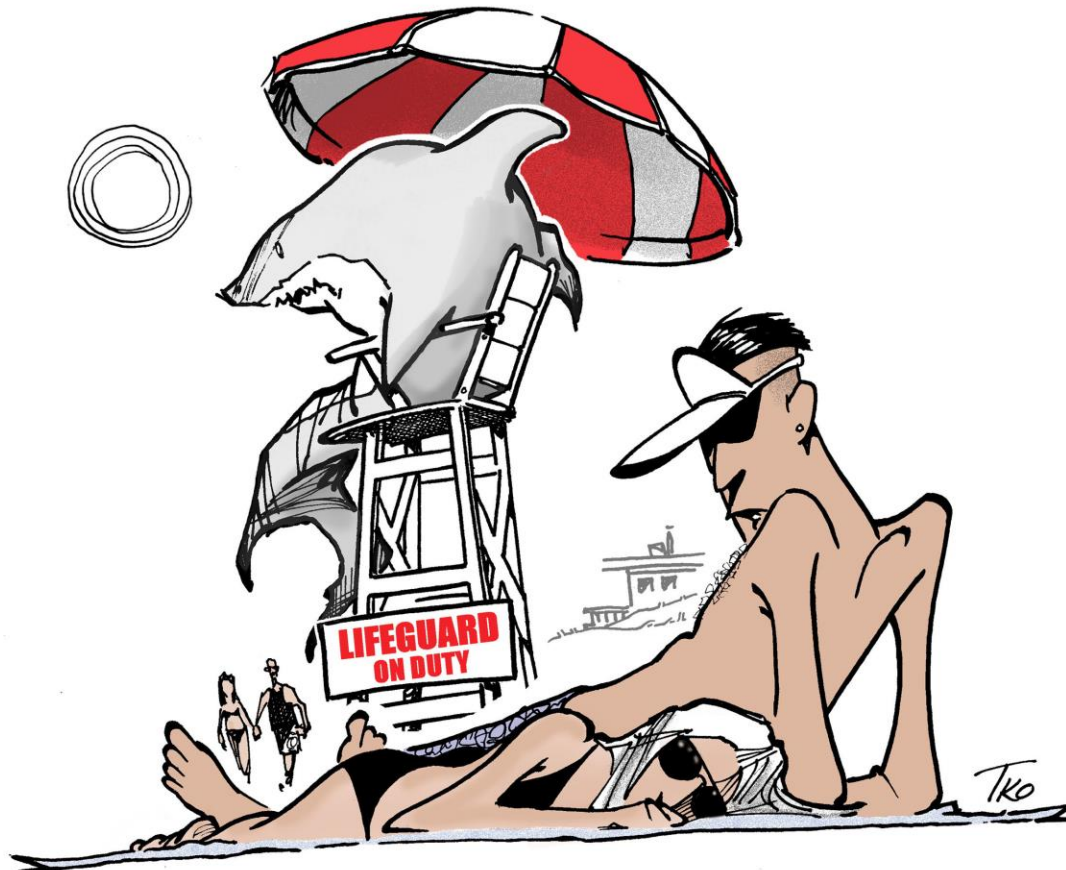
Basic Rules

Identification and Management

Key Conflict Areas

Other Conflicts

Targeted Reforms



*“So, I’m the only one who sees a
conflict of interest here?”*

- 1999: Conflicts of Interest identified as a “*more significant concern than proficiency*” – CSA Committee
- 2004: Fair Dealing Model Concept – Inspired by this concern
- Today: Client Relationship Model – Evolved out of Fair Dealing Concept Discussion – Incorporated conflict of interest principles
- The Future: Targeted Reforms – Conflicts of Interest obligations to be clarified and enhanced

- Section 75.2 of the Act
 - Registrants must deal fairly, honestly and in good faith with clients
 - Advisers with discretionary authority and investment fund managers must also act in client's best interest
- Conflict rules should be interpreted and applied in a manner consistent with the duty of care

- Take reasonable steps to identify existing and potential material conflicts between a client and:
 - the firm
 - each individual representing the firm
- Respond to each conflict of interest identified
- Disclose if reasonable investor expects to be informed of the conflict

- s. 13.5 – Restrictions on managed account transactions
- s. 13.6 – Disclosure when recommending related or connected issuer securities
- s. 13.7 to s.13.11 – Referral arrangements
- s. 13.12 – Restrictions on lending to clients
- NI's 23-101 and 23-102 – Trading rules and soft dollars
- NI 81 series, including NI 81-107 – Independent review committee for investment funds

What is a Conflict of Interest?

- Where an interest of the firm or its representatives is **inconsistent** with or **divergent** from a client interest
- Conflicts can be **existing** or **potential**



- Have policies and procedures in place
- Identify interests of each party – Are they, or could they become, inconsistent or divergent?
- Is the conflict material or might it become material?
- Conduct regular conflicts assessments
- Document

Response to Conflicts of Interest

Avoidance

Control

Disclosure

Managing Conflicts of Interest – Avoidance

- Avoid conflicts prohibited by law
- Avoid conflicts if risk of significant harm to
 - clients, or
 - integrity of the market
- Stop the activity giving rise to such conflicts
- Policies and procedures
 - Maintain inventory of conflicts
 - Train staff
 - Monitor activities



- Policies and procedures
- Monitor activities that may give rise to conflicts
- Train staff on reporting and managing conflicts
- Maintain up-to-date conflicts log
- Determine risk level for each conflict
- Mitigate risk; response should be proportionate to risk
- Advisers with discretionary authority and IFMs – Response should take into account best interest obligation

Managing Conflicts of Interest – Control

- Structure organization to control conflicts
 - Marketing reports to Compliance (not vice versa)
 - Compliance staff should not have sales-based compensation
 - Separate advising and investment banking staff
 - Set up information barriers



- Use independent review committees
 - KYP
 - Oversight over outside business activities (OBAs)
 - Related party transactions
- Independent board directors
- Independent legal and other expert advice
- Document management of conflicts

- Prominent, specific, clear and meaningful
- In advance (must include in the RDI: s. 14.2 of NI 31-103)
- Describe conflict and explain how it may affect the services offered
- Will disclosure lessen client harm?
- Disclosure of confidential information

Key Conflicts Areas

Sales Practices

Related and Connected Issuers

Outside Business Activities

Advisers and IFMs

- Are suitability or KYP assessment affected by compensation practices?
- Conflicts may arise from:
 - Trailer fees
 - Sales targets and thresholds
 - Compensation differentials between products



- Sponsored conferences and education events that influence product sales
- Reimbursement by issuer of distribution-related expenses
- Trips, gifts and other non-monetary benefits provided by issuer to dealer firms



Examples:

- Two products paying up-front commissions of 10 per cent and 5 per cent respectively
- Product A pays a trailer fee and Product B does not
- DR compensation increases if DR hits specific sales threshold
 - Increased suitability concerns as DR nears sales target

- Assess compensation structure – are there incentives that may affect suitability determinations?
- Monitor sales activity
- Perform (CCO) suitability review of commission-based trades
- Scrutinize DRs earning high compensation or nearing targets
- Disclose compensation, effect on investments
- Avoid or control conflicts relating to gifts, expense reimbursements, and other sales-related benefits

- Failure to conduct KYP at dealer level
- Inadequate disclosure about related party
- Reliance on related issuer's disclosure
- Unbalanced or overly promotional marketing on proprietary products
- Management fees

- Implement policies and procedures for dealer-level KYP
- Separate decision-making roles in issuer and dealer
- Establish independent review committee
- Document KYP and conflicts assessments
- Train staff on conflicts inherent in business model
- Provide clear and meaningful client disclosure
- Consider selling third party products alongside the securities of related/connected issuers

- OBAs include
 - Outside employment
 - Director and officer positions
 - Roles with charitable, social or religious organizations

- Concerns:
 - Competing interests for time
 - Access to confidential or insider information
 - Dual or multiple licensing (e.g., mortgage broker, life insurance, financial planning)
 - Undue influence over clients

Examples:

- Advising Rep for fund is also a director in an investee company of the fund
- Advising Rep for a MIC has an ownership stake in a construction company developing the MIC properties
- Life insurance agent who is also a DR recommends EMD product as an alternative to segregated funds

- Policies and procedures for identifying and managing OBAs
- Require approval prior to commencing OBA activity
- Ensure OBAs do not impair ability to meet client obligations or create client confusion – avoid if necessary
- Disclose to the ASC and to clients
- Supervise and monitor OBAs
- Require updated OBA lists/conduct online searches

- Section 75.2 – Best interest obligation

- Concerns:
 - NAV calculation
 - Management/Performance fees
 - Allocating investments and expenses
 - Best execution
 - Soft dollars
 - Personal and proprietary trading

- Allocation of investments by EMDs
- Different fees charged by firms to different clients
- Referral arrangements

- Requirements
 - Forms 33-109F4 and 33-109F5
 - NI 33-105
 - NI 81 series

- Guidance
 - 31-103CP
 - CSA Staff Notice 31-343
 - CSA Staff Notice 33-318

- April 2016: CSA Consultation Paper 33-404 – Targeted Reforms Proposal
- May 2017: CSA Staff Notice 33-319 – Update on Targeted Reforms
- Conflicts of Interest – Priority Area of Targeted Reforms
- Stay Tuned

Thank you!



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