Conflicted over how to identify and address conflicts?

March 31, 2021

Preparing for the new CFR conflicts of interest requirements

This is the first installment in BLG's CFR Communication Series—Surging through 2021 to 2022. This article explains how best to prepare for the CSA's new conflict of interest requirements which come into force on June 30, 2021.

Through the client focused reforms (CFR) set out in the revisions to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, the Canadian Securities Administrators (CSA) expect registrants to better align their interests with the interests of their clients. Bottom line: registrants will be expected to put the interests of their clients first.

The new rules and CSA expectations regarding conflicts of interest will be effective on June 30, 2021. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) have amended their rules and associated guidance to conform to the CFRs, in substantially similar ways.

The CFRs introduce a new standard for managing material conflicts of interest: conflicts must be addressed in the best interest of the client.

Registrants must:

- take reasonable steps to identify existing and reasonably foreseeable material conflicts of interest between a client and the firm, or any individual acting on the firm's behalf;
- address all material conflicts of interest in the best interest of the client;
- avoid material conflicts of interest that cannot be otherwise addressed in the best interest of the client; and
- provide affected clients with written disclosure of material conflicts of interest at account opening or in a timely manner thereafter.

Registered representatives must promptly report all material conflicts of interest to their sponsoring firm and refrain from any trading or advising activity in connection with a material conflict of interest unless: (i) the conflict has been addressed in the best

interest of the client, and (ii) the representative has received consent from their sponsoring firm to proceed with the activity.

A registrant will not satisfy the requirement to address material conflicts in the best interest of the client simply by providing disclosure to the client. However, disclosure of a firm's conflicts controls remains vital and updated disclosures are expected to be made available to existing clients by June 30, 2021 as well as provided to new clients opening accounts after that date.

Investment fund managers of public funds remain subject to the conflicts regime in National Instrument 81-107 *Independent Review Committee for Investment Funds* and therefore are exempt from the conflicts rules in the CFRs. A coordinated approach to conflicts for those registrants who manage public funds and carry on other business will be key.

What your firm should be doing to prepare…right now.

- Leverage what you already have.
  - Your firm will have existing policies and procedures on identifying and responding to conflicts of interest as well as some client disclosure about conflicts of interest. Work with what you have to enhance your conflicts regime in accordance with the new requirements.
- Identify your conflicts.
  - Treat this as a group brainstorming exercise. Conflicts of interest are not always obvious and all executives, representatives and staff must be able to understand when a conflict of interest may arise.
  - Conflicts will be different depending on what registrant lens you are looking through. Firms registered in multiple capacities should identify conflicts for each registrant hat they wear.
  - Examples of conflicts of interest are provided by the CSA in the Companion Policy to National Instrument 31-103 (the Companion Policy). This list is helpful; however, these conflicts should not be taken as the only conflicts of interest that could apply to your firm. And you can decide if they do not apply to your firm.
- Assess materiality of the conflicts of interest you have identified.
  - Will the conflict affect the decisions of the client? Will the conflict affect the recommendations or decisions of the registrant? If the answer to either of these questions is "yes" – the conflict exists and is likely material.
  - The Companion Policy provides examples of conflicts that the CSA consider are almost always material. Again, this list should not be treated as exhaustive or conclusive in your circumstances.
- Develop an approach on how each material conflict should be addressed in the best interest of the client.
  - Keep in mind the regulatory expectation of the CSA: when addressing the conflict, a registrant must put the interests of their client first, ahead of their own interest and any other competing considerations.
  - Remember that this means either avoiding the conflict or using controls to mitigate the conflict sufficiently so that you can say that it has been addressed in the client's best interest.
  - Identify any activity that must be prohibited because it can't be addressed in the best interest of the client.

- For others, develop mitigation techniques or controls that can be used to ensure that clients' interests are prioritized over any other competing considerations.
- The Companion Policy provides some examples of mitigation techniques for certain conflicts of interest. These can be a helpful starting point for developing controls for your business. You may have other techniques – and there is no expectation that you adopt all of the suggested controls.

- Develop tools that help assist representatives and staff to identify conflicts of interest.
- Develop a protocol for how conflicts get escalated once identified to the internal decision makers who determine how to address the conflict.
- Develop and carry out effective training programs for all executives, representatives, operational and compliance staff to ensure appropriate levels of understanding of conflicts and the firm's conflicts regime. Representatives may get questions from clients, which warrants specific focus on conflicts training, along with FAQs or other techniques to assist in responding accurately and clearly.
- Ensure that the firm's written compliance policies and procedures reflect the mechanisms for identifying, escalating and addressing conflicts of interest. Link this policy to the other policies and procedures that are intended to address the specific conflicts of interest.
- Develop plain and clear written disclosure to be given to clients about conflicts of interest and how they are addressed.
  - Leverage your existing disclosure and supplement it with the new required disclosure around the risk and impact of the conflict and how the conflict has been addressed.
  - Think about your business model – and make sure you think about conflicts in each of your categories of registration.
- Develop a plan for disclosing conflicts to existing clients by June 30, 2021.
  - **The new conflicts disclosures should be posted on websites by June 30 and electronically delivered to those clients for whom you deliver documents electronically.**
  - **The regulators have accepted that disclosure can be given to existing clients along with the second quarter statements to be sent out after June 30, where there is no ability to electronically deliver such disclosures.**
  - **Ideally, you would signal to existing clients the importance of reviewing this disclosure once it is available – many firms are providing a short description of the new disclosures with the first quarter statements to be sent out after March 31.**

How can BLG help?

With June 30, 2021 fast approaching, we would be pleased to help your firm with enhancing your compliance framework for identifying and managing conflicts in the best interest of your clients and managing the rollout of internal training, policy development and client communication.

Surging through 2021 to 2022 – BLG's vision of the client focused reforms

Please watch for the next in our series of topical articles relating to issues that have arisen for firms seeking to implement the CFRs. We will be hosting a series of webinars and podcasts to cover specific topics in accessible ways.

Our next article will focus on holding out and titles – a current source of some consternation in the industry.

We also are planning a webinar on CFR hot buttons, which will be designed to cover issues we know are top of mind for clients. This webinar is scheduled for April 28, 2021 – please watch for your invitation. There will be an opportunity to ask questions of our panel of experts, including litigation, registrant regulation and funds lawyers.

Please see our brochure for more information.

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