CIRO’s handful of proposals: Phase 5 of the rule consolidation project

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On March 27, 2025, the Canadian Investment Regulatory Organization (CIRO) published for comment Phase 5 of its Rule Consolidation Project (the Proposals) relating to the consolidation of the two sets of rules currently applicable to investment dealers (IDPC Rules) and mutual fund dealers (MFD Rules) into one. Our assessment is that the Proposals – which address significant differences between the IDPC Rules and MFD Rules that could have potential material impacts on stakeholders - will have substantial implications for both investment dealers and mutual fund dealers.

This article discusses some of the more significant proposed rule changes relating to business structures and organization, outsourcing and service arrangements, complaint handling, recordkeeping, client reporting and financial operations[1].

Business structures and organization

The following changes are particularly important for mutual fund dealers in introducing broker/carrying broker (IB/CB) relationships. The existing Type 1 to Type 4 arrangements in the current IDPC Rules are proposed to be adopted. A new, additional Type 5 arrangement is proposed, which will include mutual fund dealers in IB/CB arrangements with another mutual fund dealer. This Type 5 arrangement is intended to reflect the existing MFD Rules regarding these relationships with some modifications, and to closely align with the Type 2 relationship provided for in the IDPC Rules. Of note, and a change from the existing requirements, is that a client will be a client of **both** the IB and the CB. There will also be an impact on insurance and client reporting requirements.

The current requirement in the MFD Rules permitting Approved Persons of mutual fund dealers to engage in securities related business as an employee of a chartered bank or credit union will be adopted for mutual fund dealers.

The Proposals confirm that only Level 4 mutual fund dealers may offer margin accounts and use free cash credit balances in their operations, because only these dealers are permitted to offer nominee accounts. If a Level 4 mutual fund dealer will offer margin accounts or use client free credits, they must meet the financial solvency requirements that apply to an investment dealer and submit a business change notice for review by

CIRO before proceeding. We note that CIRO's requests for business change notices have had an impact on project timing for our clients.

Outsourcing and service arrangements

The Proposals adopt the current IDPC Rule requirements for permitted outsourcing and back-office arrangements. These include arrangements with Canadian financial institution affiliates and clearing arrangements with other dealers. The Proposals also incorporate the MFD Rule requirements for service arrangements, which are defined as arrangements with third parties that do not relate to securities and derivatives related business or responsibilities under securities law.

Complaint handling

There are numerous proposed changes to reporting and handling of complaints, including to the associated definitions. For example, there is a new definition of "complaint", and the introduction of a "non-reportable complaint" to replace the concept of a service complaint. There are new concepts of "serious client-related misconduct" and "serious misconduct." If "serious misconduct" is involved, Approved Persons and employees of a dealer must report the misconduct to the dealer firm which, in turn, has a reporting obligation to CIRO.

As there is no definition of an "employee" of a dealer, this raises questions around the application of the reporting requirement, for example, in organizations where dealer staff are employed by an affiliated entity, or under the principal agent model. Stakeholders should consider the impact of each of these revised and new definitions, including the potential impact of the open-ended definition of "serious misconduct" which triggers the mandatory reporting requirements.

With respect to internal investigations, the proposed trigger for a dealer to open an investigation is awareness of a current or former Approved Person or employee appearing to have engaged in "serious misconduct." Dealer members will be required to maintain records of an internal investigation documenting the specified information.

There are minor changes proposed with respect to the handling of institutional client complaints that relate to ensuring that complaints alleging serious client-related misconduct are addressed.

The proposed amendments to retail client complaint handling are more significant and would require that a dealer provide a written response to any "complaint" that is submitted in writing (including "non-reportable complaints") and respond to any verbal complaint that alleges "serious misconduct."

CIRO proposes to retain the requirement to provide a substantive response to a complaint within 90 days. It has also proposed time limits on internal dispute resolution services offered by a dealer member.

Recordkeeping and client reporting

The general approach under the Proposals to recordkeeping and client reporting is to harmonize the requirements, creating consistency in reporting between both dealer types as well as National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

The Proposals include a new definition intended to harmonize the mutual fund dealer concepts of "nominee accounts" and "client name assets" with the investment dealer concepts of "off book" or "outside holdings." Going forward, the distinction between nominee and client name will not be used in the consolidated rules. Instead, holdings will either be under dealer control or be "outside holdings."

With respect to client statements, mutual fund dealers may continue to provide them on a quarterly basis, unless they offer margin accounts, in which case the Proposals require reporting at the same frequency as investment dealers.

Within a trade confirmation, both investment dealers and mutual fund dealers must currently disclose whether they are acting as a principal or agent in the transaction, however, there have been different practical interpretations. CIRO has proposed to clarify that the term "principal" only captures situations where a dealer is transacting with the client from its own inventory, and not transacting as a "principal distributor" with a client. Mutual fund dealers will need to review their systems for necessary adjustments if this change proceeds.

In a welcome change, it is proposed that electronic delivery of client statements, trade confirmations and other required reports become the default format for client communications. Clients will have the right to opt in to paper delivery. CIRO does not, however, suggest how this change would be implemented at the dealer level for existing paper-based clients. As we have seen with the Canadian Securities Administrators' access equals delivery project for investment funds, the details are important and can pose logistical challenges to smooth implementation.

Financial operations

The Proposals contain significant changes, more impactful to mutual fund dealers, relating to a variety of financial operation requirements.

Minimum capital requirements will not change. However, mutual fund dealers will now be required to make a report to CIRO if an early warning test is triggered. The early warning tests for mutual fund dealers will be enhanced to include a six-month profitability test for Level 1-3 dealers. Level 4 dealers will be subject to the tests currently applied to investment dealers.

In addition, the Proposals impose significant responsibilities on mutual fund dealer Chief Financial Officers (a new requirement under Phase 4 of the rule consolidation project), that harmonize with those of investment dealer CFOs.

The two sets of rules presently contain significant differences in the criteria for an auditor to qualify to perform the audit of the year-end regulatory financial report. As is currently the case under IDPC Rules, auditors of mutual fund dealers will need to be

approved by CIRO and included in the list of panel auditors. This may result in some existing mutual fund dealer auditors being disqualified from providing audit services.

The Proposals contain numerous changes related to other financial and operational requirements, including financial disclosure to clients, custody requirements, client free credit balances, insurance requirements, financing arrangements, required margin and Form 1 content. Of note, CIRO has proposed one consolidated financial solvency report (DC Form 1) which will apply the same formula for calculating risk adjusted capital to both mutual fund dealers and investment dealers, with some differences within the formula. The form will also include some flexibility to introduce customized schedules and reporting lines for each dealer type. Another proposed requirement for mutual fund dealers is the requirement to provide a summary statement of financial position and a list of current Executives and Directors to a client upon request and adoption of the IDPC rules for pricing internal control requirements.

Comments sought

CIRO has asked stakeholders to comment on thirteen specific questions in addition to seeking general comments on the Proposals.

The Proposals are wide-ranging, and touch many of the existing rules impacting both investment dealers and mutual fund dealers. We would be pleased to assist your review of the Proposals and prepare consultation responses. The comment period expires on June 25, 2025. For more information on CIRO related topics, please see our dynamic resource here.

Footnote

[1] Continuing education (CE) harmonization is occurring as a separate project released for comment in late 2024, and thus the Proposals incorporate the current CE requirements for investment dealers and mutual fund dealers.

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