



Mutual Fund Dealers Association of Canada
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MEMBER REGULATION NOTICE

OUTSIDE BUSINESS ACTIVITIES

This Notice is intended to clarify the obligations of Members and Approved Persons regarding outside business activities. For the purpose of this Notice, reference to “outside business activities” means any business carried on by an Approved Person other than business done on behalf of the Approved Person’s MFDA Member firm.

MFDA staff have encountered a number of situations where Approved Persons have engaged in inappropriate outside business activities, which in some cases have resulted in significant client harm. Examples of some of the activities that we have identified include:

- securities sold outside of the Member, including
 - principal protected notes deemed to be securities under provincial legislation;
 - private placements;
 - limited partnerships;
 - other securities sold pursuant to exemptions from securities legislation;
- referral of securities related business outside of the Member.

Business Activities of the Member

MFDA Rule 1.1.1 requires that all “securities related business” must be conducted through the Member, with exceptions for the sale of deposit instruments not on account of the Member and the activities of bank employees conducted in accordance with the Bank Act. “Securities related business” is defined in By-law No. 1 to mean any business or activity that constitutes trading or advising in securities for the purposes of applicable securities legislation in any jurisdiction in Canada. This includes securities sold pursuant to exemptions under applicable securities legislation.

Apart from the specific exceptions noted in Rule 1.1.1, Approved Persons are prohibited from personally engaging in the sale of any investments that would be considered securities under applicable legislation, or selling or advising on such investments through any entity other than their MFDA Member dealer (often referred to as “selling away” or “off book trading”).

Members are also reminded that referral business involving other registrants, or that are otherwise connected to securities related business must also be done through the Member in accordance with MFDA Rule 2.4.2. Member Regulation Notice MR-0030 provides additional information regarding referral arrangements.

Business Activities Allowed Outside of the Member

Pursuant to MFDA Rule 1.2.1(d) an Approved Person can only be gainfully employed in a dual occupation provided that:

- the Approved Person is permitted by legislation to devote less than his or her full time to the business of the Member for which he or she acts on behalf of;
- the activity is not prohibited by a securities commission in the jurisdiction in which the Approved Person carries on business;
- the Member is aware of and has approved the outside activity;
- the Member has appropriate procedures to ensure continuous service to clients and to address potential conflicts of interest;
- the activity does not bring the MFDA, its Members, or the mutual fund industry into disrepute;
- clear disclosure is provided to clients that any activities related to such other gainful occupation are not business of the Member and are not the responsibility of the Member.

In addition, the Member and Approved Person must comply with provincial securities legislation, which generally requires full disclosure of any outside business activity and prior approval from the applicable securities commission(s).

Member Policies and Procedures

Members are required to have policies and procedures that address notification and approval of outside business activities, as well as subsequent compliance with MFDA Rules and By-laws as these relate to the activities.

Member Approval of Outside Business Activities

Members that allow Approved Persons to engage in outside business activities must have an approval process in place. As a preliminary step in the approval process, the Member must obtain from the Approved Person basic information about the activity, including the name and nature of the business, the title or position of the Approved Person, the number of hours to be devoted to the business and a description of any potential for confusion or conflicts of interest. The policies and procedures of the Member should require Approved Persons to notify the Member in the event of any material changes to significant aspects of the activity. Evidence of the review undertaken by the Member, as well as the approval, must be maintained in accordance with the record keeping requirements under the MFDA By-laws, Rules and Policies.

Some issues to consider before approving outside business activities include:

(a) Conflicts of Interest

The Member must consider issues relating to all potential conflicts of interest that may arise from the Approved Person's duties as a salesperson and his or her outside business activity. This would include consideration of the compensation to be paid under the arrangement, the nature of the relationship between the Approved Person and the outside entity, and any other potential conflicts that are identified. If any such conflict cannot be properly managed, the outside activity must not be permitted.

(b) Potential Client Servicing Issues

Members must ensure that the outside activity does not impair the ability of the Member or Approved Person to provide continuous service to clients.

(c) Standards of Conduct

The Member must be satisfied that the activity will not be inconsistent with the general standards of conduct imposed under MFDA Rule 2.1.1 and will not bring the MFDA, its members, or the mutual fund industry into disrepute.

(d) Nature of the Activity

The standard of review in considering whether to approve outside business activity will depend on the nature of the activity. It is expected that the review process regarding the investment of client funds or financial services provided outside of the Member which are not otherwise regulated would be more stringent than that applied with respect to activities that are clearly unrelated to the Member's business. As a best practice, such review should include consideration of educational, experience or other relevant competency thresholds that may reasonably be expected as a prerequisite to allowing certain financial service activities.

(e) Risk Management Issues

The Member should recognize the potential exposure to complaints and litigation against the Member in the event the activity is permitted.

(f) Ability to Supervise

The Member should evaluate its ability to satisfy supervisory requirements regarding the outside business activity, as outlined below, and consider the effect such requirements will have on resources.

Ongoing Member Obligations

While Members do not have specific obligations under the Rules to supervise the approved outside business activity itself on an ongoing basis, Members do have a duty to monitor the activities of their Approved Persons in relation to compliance with MFDA Rules and applicable securities legislation. Therefore, Members have an ongoing obligation to ensure that the distinction between Member business and outside activity is properly disclosed to clients. Such disclosure must clarify that the outside business activity is not the responsibility of the Member. In addition, Members have an ongoing obligation to monitor for conflicts of interest and must

follow up on all client complaints that relate to the outside business activity.

Members are also required to take reasonable measures to look for evidence of undisclosed outside business activities of their Approved Persons.

Effective processes can be implemented using many of the Member's existing review procedures. For example:

(a) Advertising Reviews

Advertisements reviewed by the Member pursuant to MFDA Rule 2.7.3 may contain references to activities of which the Member is not aware.

(b) Website Reviews

Members are required to review websites of their Approved Persons to ensure compliance with MFDA Rules. Websites of Approved Persons may include references to activities that have not been properly disclosed. For more information on this issue, Members should refer to Member Regulation Notice MR-0033.

(c) Approval of Trade Names

Trade names used by Approved Persons require the prior written consent of the Member. As part of the approval process, Members should be asking their Approved Persons what business they intend to conduct under the trade name.

(d) Branch Reviews

Members should be considering outside business activities in interviews with Approved Persons and client file reviews when conducting branch reviews.

(e) Approved Person Questionnaires

As a best practice, Approved Person questionnaires may be employed to periodically update head office on dual occupations.

(f) Trade Reviews

In conducting trade reviews, Members should look for patterns of redemptions where there is no repurchase, as this could suggest that an Approved Person is making recommendations aimed at funding client participation in outside activities.

(g) Due Diligence in Recruitment

When recruiting new Approved Persons, questions regarding outside business activities should be included in the due diligence process before completing or transferring the candidate's registration to the Member firm.

(h) Review of Commission Reports

Unexplained decreases in book size or commission levels received by an Approved Person may indicate movement of client assets to other business investment activities offered to clients by the Approved Person.

Member Response to Supervisory Issues

Where a Member becomes aware of an Approved Person's undisclosed outside business activity, it would generally be expected that the Member conduct a reasonable investigation to ensure that the issues noted above have been properly addressed. In order to meet their supervisory obligations under MFDA Rules, Members must ensure that they have access to any files necessary to complete the investigation into the nature and extent of any undisclosed outside business activity. The Member must take steps appropriate for the type of activity identified, being particularly alert to potential client concerns. Members must take action to resolve any issues, such as by providing disclosure to clients, consideration of discipline, or other suitable measures.

Any information received by a Member that would suggest the outside activities of an Approved Person may bring the Member or the mutual fund industry into disrepute must be followed up. Any client complaints received by the Member that relate to outside business activity must be dealt with in accordance with the provisions of MFDA Policy 3 "Handling Client Complaints". As required under Policy 3, complaints involving allegations of theft or misappropriation of funds or securities or of forgery must be promptly reported to the MFDA.

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